Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1998

JACQUELINE RAGAN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition For Writ Of Certiorari
To The United States Court of Appeals
for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

Thomas E. Redding
Counsel of Record
Redding & Associates, P.C.
515 Post Oak Boulevard, Suite 500
Houston, Texas 77027-9408-150
(713) 965-9244 (Office)
(713) 621-5227 (Fax)

Bruce Rose
Dvorak & Edmonds, Ltd.
1127 South Manhein Road
Westchester, Illinois 60154
(708) 345-9880 (Office)
(708) 345-9854 (Fax)

78 pp

QUESTIONS PRESENTED

1. For purposes of federal income tax refunds, where the refund is requested by one spouse based on his community property one-half interest in the earned income of the other spouse, is each spouse treated as the owner of one half of the refund pursuant to this Court's decision in *Hopkins v. Bacon*, 282 U.S. 122 (1930), or is *Bacon* now overturned and the right to a refund vested solely in the wage earner spouse because the source wages were the sole management and control community property of the wage earner spouse; and if *Bacon* is overturned, is each spouse now to be treated as the owner of 100% of the community property wages earned by that spouse for both refund and liability determinations?

2. Whether the Internal Revenue Service and its attorneys have a right to assert legal positions in the name of protecting the public fisc, and whether such a right to protect the fisc overrides counsel's obligation to ground its pleadings in fact and existing law as mandated by Tax Court Rule 33.

3. Whether, under Tax Court Rule 33 the Internal Revenue Service and its counsel may rely solely on a pre-litigation statutory notice of deficiency when stating the Service's factual and legal positions in court pleadings without conducting reasonable inquiry as to the bases for those positions.

4. Whether the duty to conduct reasonable inquiry into the factual and legal basis of a claim or defense pursuant to Tax Court Rule 33 is abrogated for the Internal Revenue Service and its attorneys as the complexity of the litigation increases.

TABLE OF CONTENTS

QUESTIONS PRESENTED i

OPINIONS BELOW 2

JURISDICTION 2

STATUTES, REGULATIONS AND RULES INVOLVED 3

STATEMENT OF THE CASE 3
- Statement of the Pre-Petition Facts 3
- Proceedings in the Tax Court and Post-Petition Facts related to the Sanctions Issue 4
- Proceedings on Appeal 6

REASONS FOR GRANTING THE PETITION 7
- The Refund Issue 7
- The Sanctions Issue 11
  - IRS Counsel Have a Duty to Investigate 12
  - Litigation Positions Do Not Override Ethical Obligations 13
  - Complex Litigation Should Compel a Heightened Duty of Due Diligence 14

CONCLUSION 17

APPENDIX ..... App. 1

TABLE OF AUTHORITIES

Cases

Bouterie v. Commissioner, 36 F.3d 1361 (5th Cir. 1994) 11
Gehrig v. Shreves, 491 F.2d 668 (8th Cir. 1974) 9
Hopkins v. Bacon, 282 U.S. 122 (1930),
aff'g 38 F.2d 651 (5th Cir. 1930) 2, 7-11
In re Bathrick, 1 B.R. 428 (S.D. Tex. 1979) 9
Lennox v. Commissioner.,998 F.2d 244 (5th Cir. 1993) 11
Powell v. Commissioner, 91 TC 673 (1988) 11, 13, 14
Stafford v. Commissioner, 73 TCM (CCH) 2814 (1997) 7
Stewart v. Commissioner, 95 F.2d 821 (5th Cir. 1938) 2, 7, 11

Statutes

11 U.S.C. §541(a) 8
11 U.S.C. §541(a)(2) 8
26 U.S.C. §6402(a) 11
26 U.S.C. §6673 ..... 6, 13, 14, 16
26 U.S.C. §7482(a)(1) 3
26 U.S.C. §7482(b)(1)(A) 3
28 U.S.C. §1254(l) 2

Rules

Federal Rule of Civil Procedure 11 5
Tax Court Rule 33 ..... 3, 5, 6, 11-14, 16

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PETITION FOR WRIT OF CERTIORARI

Jacqueline Ragan respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The orders, opinions and decisions relevant to this case are reproduced verbatim in the Appendix attached hereto at the pages shown:

Tax Court Order (denying motion for sanctions), unpublished, dated Mar. 22, 1995 ..... App. 2 - 3

Tax Court Memorandum Opinion, 69 T.C.M. (CCH) 2470 dated Apr. 20, 1995 ..... App. 4 - 17

Tax Court Order (denying amended and renewed motion for sanctions), unpublished, dated Apr. 29, 1996 ..... App. 18 - 24

Tax Court Order (denying 1980 refund claim), unpublished, dated Jan. 23, 1997 ..... App. 25 - 34

Fifth Circuit Opinion, 135 F.3d 329 dated Feb. 17, 1998 ..... App. 35 - 46

JURISDICTION

The judgment of the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") was entered on February 17, 1998. Appellant's Suggestion for Rehearing *En Banc* was filed on March 18, 1998 and denied on April 24, 1998. Under its local rule no. 35 the Fifth Circuit treats a suggestion for rehearing *en banc* as a petition for panel rehearing and this petition is timely.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(l). The compelling reasons why the court should issue a writ in this case are:

(1) with regard to the refund issue the Fifth Circuit's holding is in direct conflict with:

  (a) its own long standing precedent in *Stewart v. Commissioner*, 95 F.2d 821 (5th Cir. 1938); and

  (b) this court's prior decision in *Hopkins v. Bacon*, 282 U.S. 122 (1930), *aff'g* 38 F.2d 651 (5th Cir. 1930).

(2) with regard to the issue of sanctions the Fifth Circuit sanctioned actions of the United States Tax Court's ("Tax Court") so far departed from the accepted and usual course

of judicial proceedings as to call for an exercise of this Court's supervisory power.

STATUTES, REGULATIONS AND RULES INVOLVED

The pertinent statutes, regulations and rules are reprinted verbatim in the Appendix attached hereto beginning at:

11 U.S.C. §541(a) ..... App. 47
26 U.S.C. §6402(a) ..... App. 49
26 U.S.C. §6673 ..... App. 50
Texas Family Code §3.102(a) ..... App. 52
Fed. R. Civ. Proc. 11 ..... App. 53
Tax Court Rule 33 ..... App. 56

STATEMENT OF THE CASE

This case arises from the decision of the Fifth Circuit to uphold the United States Tax Court's ("Tax Court") determination that:

(1) Jacqueline Ragan is not entitled to any portion of the 1980 refund claim paid by the Internal Revenue Service ("IRS") to David Ragan's bankruptcy estate, and

(2) the IRS should not be held accountable, via sanctions pursuant to Tax Court Rule 33, for the failure of the IRS and its counsel to conduct reasonable inquiry into the factual and legal basis of the claims and defenses asserted in this case.

The Fifth Circuit had jurisdiction to review this case pursuant to 26 U.S.C. §7482(a)(1) and (b)(1)(A).

1. Statement of the Pre-Petition Facts.

Jackie and David Ragan reside in Texas and filed joint income tax returns for 1980-84. The income reported for 1980 derived from Mr. Ragan's ("David") wages from his employment. In April, 1985, the Ragans requested an income tax refund for 1980 due to a large net operating loss carryover from their 1984 return. The IRS asked the Ragans to extend the statutes of limitations for the relevant returns in order to conduct an audit to determine if they were entitled to a refund. The Ragans agreed to do so, and the audit commenced in April, 1985. See App. 35.

In August, 1985, David filed a voluntary petition in bankruptcy.

As part of that proceeding, he asserted a claim of $108,935 against the United States which was the amount of the refund the Ragans sought for 1980. The IRS filed a claim against David's bankruptcy estate for $11 million. In addition, the IRS argued that any refund to which David was entitled was subject to setoff for the employment taxes they alleged he owed. Over David's objection, the bankruptcy trustee and the IRS entered into a court-approved settlement under which the IRS paid the trustee the 1980 refund, offset by alleged unpaid pre-petition employment taxes, penalties, and interest, and dropped its $11 million claim against David's estate. *Id.*

In June, 1987 David turned over to the IRS all of his financial records. *Id.*

In late 1989, Jackie terminated her extension of the statutes of limitations on the joint tax returns. On April 27, 1990, the IRS sent Jackie a statutory notice of deficiency for at least $1.7 million in income taxes and penalties for 1980-82. The notice of deficiency also demanded that Jackie repay $50,695.31 for the "erroneous" 1980 refund the IRS paid to David's bankruptcy estate and disallowed other expenses and losses. *Id.*

2. **Proceedings in the Tax Court and Post-Petition Facts related to the Sanctions Issue.**

On July 30, 1990, Jackie filed her petition in the Tax Court in which she (i) contested the notice of deficiency and (ii) asserted that she was entitled to one-half of the 1980 refund previously paid to David's estate. On September 26, 1990, the IRS filed an answer to Jackie's petition in which it denied that any of the allegations in the notice were erroneous and also denied Jackie's request for half of the 1980 refund. *Id.*

On September 29, 1992, the IRS notified David and Jackie that there was "no-change" in their tax liability for 1980-1984, with the exception of adjustments made to two (2) national, public limited partnerships in which David and Jackie were passive investors. Jackie and the IRS eventually settled the adjustments to those two partnerships also. *Id.*

On May 20, 1993, the Tax Court set the case for trial on the October 25, 1993 docket.

On October 8, 1993, the IRS concede all issues in the notice of

deficiency (with the exception of the two passive limited partnerships which later settled.) The $6,250,000 adjustment originally proposed in the notice of deficiency had been reduced to only $500,000, and more than $1.5 million in tax, penalties and interest was reduced to "zero." After the IRS' concession of the deficiencies, Jackie continued to pursue her claim for one-half of the 1980 refund. At docket call on October 25, 1993, the IRS entered a stipulation with regard to all issues in the case, with the exception of the claim for refund. The case did not proceed to trial. On October 12, 1994, in a telephone conference, the Tax Court set a schedule for disposing of the remaining issues in the case.

On October 8, 1993, the same day the IRS "officially" conceded all the proposed adjustments (except for the two passive limited partnerships), Jackie filed a motion for sanctions under Tax Court Rule 33 (the equivalent of Federal Rule of Civil Procedure 11). In the motion for sanctions, Jackie alleged that the Commissioner's attorney could not have denied that the adjustments in the notice of deficiency were erroneous and signed the answer to Jackie's Tax Court petition in good faith and the answer had no basis in fact or law. Jackie proved that the IRS had had all relevant documents and information for five years prior to issuing the notice of deficiency and, given the IRS' subsequent full concession, the adjustments asserted in the notice of deficiency had little or no basis in reality. The IRS filed a response to the motion for sanctions alleging that the answer was filed in good faith and had adequate factual foundation. On March 22, 1995 the Tax Court denied Jackie's motion for sanctions. *Id.*

On April 20, 1995, the Tax Court entered a memorandum opinion denying Jackie's request for half of the 1980 refund. 69 T.C.M. (CCH) 2470. On September 1, 1995, the Tax Court entered its Decision denying the refund claim. [1]

On October 2, 1995, Jackie filed (i) a motion for reconsideration

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[1] As a direct consequence of this Tax Court decision, the IRS is presently seeking collection from Jackie of over $250,000 in interest on the 1981 tax deficiency related to **100%** of **David's** wages that it did not pursue against David and which would have been offset by Jackie's denied 1980 refund had the IRS not, by *ex parte* agreement with David's bankruptcy trustee, applied her 1980 refund to an alleged and contested separate nonincome tax liability of David's with respect to which Jackie had no liability whatsoever. The tax law may not be equitable, but it should at least be consistently and fairly interpreted.

regarding her §7430 request for fees and costs, and (ii) a renewed motion for sanctions against the IRS. On October 5, 1995, the Tax Court treated the motion for reconsideration of her request for fees and costs as a motion to vacate the September 1, 1995 decision and ordered the IRS to file a response. On December 29, 1995 the Tax Court vacated the September 1, 1995 decision.

On December 28, 1995, Jackie filed an amended, renewed motion for sanctions. In the amended, renewed motion she re-urged her earlier argument that the Commissioner's attorney had violated Tax Court Rule 33 by filing an answer that was not well grounded in fact or law. Jackie also asserted that the IRS' response to her earlier motion for sanctions violated Tax Court Rule 33, that the response had no basis in fact or law, and that the response was based on perjury and false evidence. Jackie also asked for costs pursuant to §6673, asserting that IRS counsel unreasonably and vexatiously multiplied the proceedings, for example, by filing an answer and response that were not based on fact or law and by refusing to cooperate in discovery. The Tax Court denied the amended, renewed motion for sanctions on April 26, 1996.

On January 23, 1997, the Tax Court entered a decision denying Jackie's request for half of the 1980 refund and also denying her petition for fees and costs pursuant to §7430. The part of the January 23, 1997 decision which addressed the §7430 request for fees and costs is not a part of this *petition for writ of certiorari*.

On February 24, 1997, Jackie filed her notice of appeal from the denial of her refund claim and the denial of her motion for sanctions (as well as the denial of her request for fees and costs).

3. <u>Proceedings on Appeal</u>.

Jackie appealed to the Fifth Circuit from the Tax Court's (i) denial of the 1980 refund claim, (ii) denial of her motions for sanctions, and (iii) decision on her petition for fees and costs.

After briefing and oral argument the Fifth Circuit entered its opinion on February 17, 1998 affirming the Tax Court's denial of Jackie's refund claim and denial of her motions for sanctions. (The Fifth Circuit reversed the Tax Court's decision which awarded limited fees and costs and remanded back to the Tax Court for a new calculation of fees. However, that fees and costs decision is not a part of this *petition for writ of certiorari*.)

On March 18, 1998 Jackie filed her Appellant's Suggestion for Rehearing *En Banc* based on the belief that the February 17, 1998 opinion is contrary to the prior decisions of the United States Supreme Court in *Hopkins v. Bacon*, *supra.* and the Fifth Circuit in *Stewart, supra.* Under the local rules, the Fifth Circuit treated the Suggestion for Rehearing *En Banc* as a Petition for Panel Rehearing and denied the suggestion on April 24, 1998.

REASONS FOR GRANTING THE PETITION

1. The Refund Issue

The Fifth Circuit's holding in the case at bar (*Ragan*) is in direct conflict with and effectively overturns this Court's opinion in *Bacon*, at least in the Fifth Circuit.

In *Bacon*, the Fifth Circuit originally held and this Court affirmed that Texas community property wages were to be divided between spouses, and each spouse treated as the owner of one half for federal income tax purposes. It was determined that each spouse must report one half of the wages of both spouses on his or her tax return if separate returns are filed and that the spouses were entitled to file separate returns.

Specifically, *Bacon* held:

> In view of what has been said in *Poe v. Seaborn*, *supra*, it remains only to say that the interest of a wife in community property in Texas is properly characterized as a present vested interest, equal and equivalent to that of her husband, and that one-half of the community income is therefore income of the wife. **She and her husband are entitled to make separate returns, each of one-half of such income.**
>
> 282 U.S. at 122. [Emphasis added.]

Under *Bacon*, the spouses must each treat one half of all wages as his or her own. Therefore, if the spouses elect to file separate returns, each is severally and personally liable for the income taxes on one half of the wages of the wage earner spouse's income and entitled to one half of any overpayment of the taxes.

Bacon continues to be the black letter law on this issue. See *Stafford v. Commissioner*, 73 TCM (CCH) 2814, 2817 (1997), citing, *Bacon*.

IRS revenue rulings have been consistent with *Bacon*:

(a) the IRS recognized that when a husband and wife file a joint return, each has a separate interest in the jointly reported income and in any overpayment. Rev. Rul. 74-611.

(b) "In a community property state, each spouse is considered the recipient of one half of the wages upon which taxes are withheld and thus is entitled to a credit for one half of the taxes that are withheld." Rev. Rul. 80-7.

The Fifth Circuit reviewed whether Jackie was entitled to one half of the 1980 refund based on the *de novo* standard of review. *Ragan*, at 333. The Fifth Circuit recognized that Jackie's entitlement depends on its legal classification under Texas's community property regime but erroneously held that:

> [W]e hold that, to the extent that the income is attributable to one spouse's sole management community property, the refund from the excess tax on that income is the sole management community property of that spouse. Jackie is not entitled to any portion of the 1980 refund.
>
> *Id.*

This conclusion is erroneous and represents a complete reversal of this Court's holding in *Bacon*, and the effect of federal law on the powers of the parties to a joint return.

Jackie did not dispute that the 1980 refund derived solely from the excess withholding from David's personal earnings but argued that pursuant to *Bacon* the characterization of the refund rests on who has control over the right to the refund.

The Fifth Circuit determined that under 11 U.S.C. §541(a), David's bankruptcy estate included "[a]ll interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is under the sole, equal, or joint management and control of the debtor." *Id.* 11 U.S.C. §541(a)(2). Therefore, Jackie could prevail on her claim only if one half of the 1980 refund was community property under her sole management and control. *Id.*

Ignoring *Bacon*, the Fifth Circuit relied on what it referred to as "persuasive authorities" for its reasoning that "the source of an

overpayment of income tax determines the character of the refund, with a refund of excess withholding tax merely being a repayment of earnings from employment." *In re Bathrick*, 1 B.R. 428, 430 (S.D. Tex. 1979); see also *Gehrig v. Shreves*, 491 F.2d 668, 671-72 (8th Cir. 1974). In Texas personal earnings are community property subject to the sole management and control of the spouse who earned them. Tex. Family Code Ann. Sec. 3.102(a) (West Supp. 1998). From this, the Fifth Circuit erroneously concluded that "the tax refund generated from the excess withholding of those earnings is as well." *Id.*

In *Ragan* the Fifth Circuit erroneously held that the right to a refund of income taxes paid on the wages of one spouse is the sole management and control community property ("SMCCP") of that spouse solely because wages are the wage earner's SMCCP when the wages are earned. The Fifth Circuit ignored *Bacon* and all of the revenue rulings and other judicial precedent and erroneously concluded that Jackie was not separately entitled to refund of one half of the tax overpayment as her SMCCP.

Contrary to *Bacon*, *Ragan* holds that a spouse (Jackie) was not entitled to have filed a separate return or claim for refund by reporting one half of the wages and seeking one half of the overpayment. *Ragan* holds that the refund claim is the wage earner's (David's) SMCCP, and only the wage earner (David) had a right to seek a refund of any of the taxes overpaid on his wages.

Bacon and *Ragan* cannot be reconciled. *Bacon* mandates that each spouse be treated as the owner of one half of the wages and that the federal income tax laws be applied accordingly. *Ragan* says that the non-wage earner spouse (Jackie) has no power over the right to a refund of any overpaid taxes on the one half of the wages of which *Bacon* mandates she be treated as owner.

If allowed to stand, *Ragan* would result in Jackie's being recognized as owner of one half of the wages for purposes of taxing her,[2] but denying her ownership for purposes of a refund claim by holding the right to the refund to be solely subject to David's control.

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[2] Ironically, the IRS is following *Bacon* for exactly this purpose by presently pursuing collection against Jackie for over $250,000 of interest accrual on a tax deficiency arising out of David's SMCCP wages in 1981!

This is in direct conflict with *Bacon* which precludes David from having any right to claim more than one half of the refund because it prohibits him from filing a separate return reporting 100% of the wages and withholding.

The ultimate result of *Ragan*, when read in conjunction with established law under *Bacon*, would be that each spouse is severally liable for income tax on 50% of all community wages but if there is excess withholding, unless a joint tax return is filed to claim the refund, then under *Bacon* the wage earner can file separately for a refund of only 50% of the overpayment, and under *Ragan* the non-wage earner spouse can file separately for **none** of the refund. Under that interpretation, if a married couple files separate returns in Texas, the Government gets a windfall of 50% of any overpayment. This is grossly erroneous and would compel estranged or separated spouses to file joint returns where there is any overpayment to be claimed, forcing the parties to elect between (i) joint and several liability for any deficiency if their original position that there is an overpayment is erroneous (by having to elect to file a joint return), or (ii) losing the non-wage earner's one half of the overpayment forever. Alternatively, if *Ragan* is interpreted as allowing the wage earner to file separately claiming 100% of the refund, *Bacon* has been reversed.

The Fifth Circuit's erroneous ruling in *Ragan* results from the failure to recognize that although the nature of the refund as community property is established under Texas property law, the powers of control over that property may shift by agreement of the parties or by operation of law, changing its status from David's SMCCP, when owed to him or received by him as wages, to some other form of community property having different rights of control.

The simplest example by analogy would be a bank account solely in the name of Jackie on which David had no signature authority. If one half of David's wages were deposited into Jackie's account, they would continue to be community property, but they would be community property subject to Jackie's sole management and control.

That example by analogy is exactly what occurred when the federal income taxes on 100% of David's wages were paid over to the IRS at which point, under federal law, the tax liability and powers over refund claims became divided between Jackie and David.

This Court's holding in *Bacon* is consistent with the relevant

statute. The statutory language of 26 U.S.C. §6402(a) provides that "[i]n the case of any overpayment, the Secretary ... may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c) or (d), refund any balance **to such person.**" [Emphasis added.] This is mandatory and can only be interpreted to mean Jackie was solely entitled to her one half of the 1980 refund as the "**person who made the overpayment.**" [Emphasis added.]

Consistent with *Bacon*, the Fifth Circuit has held that deductions related to community income are allowed one half to each spouse. *Stewart v. Commissioner*, 95 F.2d 821 (5th Cir. 1938).

The *Ragan* opinion denying that each spouse has an equal and independent right to a refund of one half of the taxes overpaid on the community income is irreconcilable with *Bacon* and *Stewart* and contrary to 26 U.S.C. §6402(a).

Ragan's holding that the taxes paid on 100% of David's wages were David's SMCCP is squarely and diametrically in conflict with *Bacon* and should be overturned.

2. The Sanctions Issue

Tax Court Rule 33, like its counterpart Federal Rule of Civil Procedure 11, was adopted to deter parties and their counsel from squandering scarce judicial resources and wasting their opponent' time, energy, and money by filing, and later litigating over, pleadings filed without adequate investigation and lacking objectively reasonable factual and/or legal bases. Nevertheless, the IRS and its counsel have repeatedly been found to have stated positions in court-filed pleadings -- just as they did here -- which were based on little or no investigation and which were bereft of any factual and/or legal bases. In addition to this case, *see e.g.*, *Bouterie v. Commissioner*, 36 F.3d 1361 (5th Cir. 1994); and *Lennox v. Commissioner*.,998 F.2d 244 (5th Cir. 1993). Even the Tax Court occasionally finds that the IRS has gone beyond the bounds of propriety as in *Powell v. Commissioner*, 91 TC 673, 679 (1988) (IRS' position "borders on being frivolous and was entirely without a legal or factual foundation.").

Powell perfectly frames the sanctions issue in this petition. Unlike any other litigant, in cases where the IRS' litigation positions are

found to lack any factual or legal basis this complete lack of any basis for its pleadings is held only to "**border**... on being frivolous" (emphasis added) and sanctions are not imposed. Indeed, petitioner's research has failed to uncover even **one** case where the Tax Court has imposed sanctions against the IRS under Tax Court Rule 33 .

The lower courts' continuing indulgence of the IRS' disregard for the most fundamental of legal and ethical requirements of pleading encourages the IRS and its counsel to continue this conduct. The ongoing tolerance of this behavior leads to the dissipation of judicial and governmental resources, as well as the time, money and energy of innocent, taxpaying citizens. This Court should address this issue and set guidelines for the conduct of the IRS in the lower courts by making it and its counsel subject to sanctions like any other litigant. The extreme nature of the facts of this case make it the appropriate vehicle in which to address these issues.

a. IRS Counsel Have a Duty to Investigate.

Under Tax Court Rule 33, counsel are obligated to investigate the basis of claims and defenses asserted in their pleadings. In this case, Jackie asserts that the IRS' concession of almost all of the adjustments it had originally sought is proof that the IRS maintained a litigation position in its answer that it knew or should have known was not based on fact or law.

In its response to Jackie's motions for sanctions, the IRS argued that all of its pleadings were based upon the IRS' statutory notice of deficiency (although the IRS never explained how the asserted deficiencies were determined for the notice) and that all other errors in its pleadings resulted from, among other things, the inability of IRS counsel and their paralegal to read the IRS' own deficiency notice as well as their lack of knowledge concerning their own administrative files. (R.6:69/4-16, 20-24). The IRS further explained that its response to Jackie's original sanctions motion simply repeated -- albeit erroneously -- the contentions of the deficiency notice without any attempt by counsel to verify the accuracy of the statements in the deficiency notice.

The answer to Jackie's Tax Court petition was drafted by the same IRS attorney who had approved the issuance of the deficiency notice, Jeffrey Kelm ("Kelm"). Kelm left the IRS in February 1992. (R.6:69/4-16, 20-24). When the IRS asked Kelm to provide an

affidavit to explain the bases for the deficiency notice and the IRS answer he had prepared and filed, Kelm claimed that he could not recall. In its response, the IRS argued that, even though Kelm could not recall why he had taken the positions he had in the deficiency notice and answer, he *must* have had good reasons, even if no one knew what they were. (R.6:69/4-16,20-24).

IRS counsel should not rely solely on a pre-litigation, statutory notice of deficiency when stating factual and legal positions in court pleadings. This is especially true after the taxpayer has filed a Tax Court petition and other pleadings that set forth factual and legal errors in the IRS' notice of deficiency. Sanctions should lie when the only explanation the IRS can provide in response to proven errors in its pleadings is (i) "I can't recall," (ii) we didn't understand the notice, and (iii) we aren't familiar with the files.

For Tax Court Rule 33 to be applied without violating the Equal Protection Clause, this Court should hold that the IRS and its counsel, like any private litigant and his, her, or its attorneys, cannot rely blindly on some preliminary determination and thereafter stand on that determination without any subsequent investigation and without having to explain how that original determination was made. This Court should hold that the IRS' deficiency notices do not shield it and its counsel from their duties to have a reasonable basis in fact and in law for pleadings they file in this nation's courts. This Court should also hold that, at least in this case, the failure of the IRS and its counsel to carry out these duties unreasonably and vexatiously multiplied these proceedings in violation of §6673 and should impose appropriate sanctions.

b. Litigation Positions Do Not Override Ethical Obligations.

The IRS and its counsel frequently justify their litigation positions by stating that the positions are taken to "protect the Service," *i.e.*, the public fisc. By this assertion, the IRS claims that it is protecting the public revenue. *Powell* at 679. IRS counsel made the same assertion in this case with regard to its position on the 1980 refund issue.

The lower courts have allowed IRS counsel to assert such positions so long as there is "good cause." *Id.* However, the IRS' apparent legal right to assert positions "to protect the Service" does not override the obligations of IRS legal counsel as officers of the court to comply with Tax Court Rule 33. At the very least, "good

cause" should include a factual and legal basis for the claim. As reflected in cases like *Powell* and this case, all too often, no such legal and factual basis exists. In those cases the IRS neither has support for claiming that it is protecting the public fisc, nor for claiming that it has any good faith basis for asserting its position before a court. In this case, it was expressly found that the IRS was abusing its power by asserting a position on which it never expected to prevail. App. 40. The IRS simply asserts such positions as a stall tactic or a dodge to buy time to settle the case.

Such conduct is clearly contrary to both Tax Court Rule 33 and Rule 11 and would result in substantial sanctions against any private counsel or litigant caught engaging in such unethical conduct. Nevertheless, as here, the lower courts continue to deny private litigants equal protection by making contradictory findings that the IRS and its counsel have no legal or factual basis for their litigation positions, but that sanctions are not warranted. This Court should accept this petition as an opportunity to set clear guidelines for the future conduct of the IRS and its counsel and to determine when sanctions are appropriate. Additionally, this Court should also hold that, at least in this case, the failure of the IRS and its counsel to carry out these duties unreasonably and vexatiously multiplied these proceedings in violation of §6673 and should impose appropriate sanctions.

c. Complex Litigation Should Compel a Heightened Duty of Due Diligence.

It follows that under Tax Court Rule 33, complex litigation should *compel* the IRS and its counsel to review all documents in their possession and control -- both the IRS' own documents and the taxpayer's documents -- prior to filing pleadings containing factual and legal allegations about those documents; it should not absolve them of the responsibility to do so as the Fifth Circuit held.

In this case, the IRS and its counsel had complete access to all relevant documentation and delayed in conducting due diligence, and then conducted only cursory due diligence. As the Fifth Circuit found, in 1985 the IRS began an audit of Jackie *five* years before the deficiency notice was issued. The IRS and its counsel were not only given complete access to all of Jackie's documents during the audit, Jackie's husband eventually gave all of their financial documents to the IRS in 1987. App. 36. The IRS held the documents until mid-

1991, one year after the deficiency notice was issued. Even though the IRS and its counsel had five years to examine, audit, question and otherwise test the documents provided by Jackie and her husband, the IRS and its counsel did not complete the audit until September, 1992, seven and a half years after the audit began, and two and a half years after the deficiency notice had been issued.

The IRS had even had an earlier opportunity to review and litigate the same adjustments that had been proposed in the deficiency notice. In 1985, five years before it issued the notice of deficiency, the IRS and its counsel filed an $11 million claim in the bankruptcy proceedings of Jackie's husband. The IRS withdrew that claim in 1989 and paid the bankruptcy estate a refund. App. 36.

Several months after withdrawing its bankruptcy claim and paying a refund to the estate, the IRS, with the approval of Mr. Kelm, its District Counsel, (R.1:23/Exh.B at 9-10), issued the deficiency notice to Jackie disallowing all of the deductions that the Ragans had reported, although the deductions were based on the same documents that the IRS and its counsel had had for five years. The deficiency notice not only requested repayment from Jackie of half of the refund paid solely to her husband's bankruptcy estate, but it disallowed deductions for several limited and general partnerships on the purported basis that the deductions were based on "sham, prearranged" government securities transactions engaged in by the partnerships. App. 36, (R.1:2). The deficiency notice also disallowed deductions for her husband's government securities and commodities futures trading as well as the Ragans' farm losses on the basis that they were all "tax motivated shams." (R.1:2).

In her Tax Court petition, Jackie challenged the validity of the adjustments proposed in the notice of deficiency. The IRS' answer denied that there were any errors in the determinations. The IRS and its counsel litigated with Jackie based on these positions for the next three years. The IRS and its counsel even continued to seek disallowance of the deductions one year after the IRS had issued a letter stating that, following completion of the Ragans' audit, there were no material changes in their tax returns for the subject years. App. 35.

If the IRS and its counsel had reviewed their own correspondence and seen the "no-change" letter, then the litigation could have been concluded one year earlier. If the IRS and its counsel had even

glanced at the partnership tax returns and the Ragans' K-1s *filed with the IRS* -- a task akin to a private attorney actually reading a contract before filing a breach of contract claim -- then the IRS would have seen that none of the Ragans' partnerships had engaged in government securities trading.

If the IRS and its counsel had simply read the Ragans' tax returns, much less the Ragans' financial documents, during the five years before the litigation began, then the IRS and its counsel would have seen that, far from being a tax dodge, the Ragans actually made approximately $1 million net profit from David's government securities and commodities trading. The Ragans paid taxes on that profit. If the IRS had followed through and actually disallowed all of the trading, the adjustments would have resulted in a refund of several hundred thousand dollars to the Ragans.

If the IRS and its counsel had actually gone through the farm-related documents during the first two years of the audit, or during the three subsequent years when the documents were in the IRS' exclusive possession and control, then those deductions could have been verified and approved long before the Tax Court litigation began. The IRS and its counsel admittedly failed to review those documents.

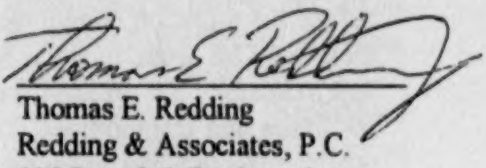
The Fifth Circuit excused the failure of the IRS and its counsel to conduct due diligence with regard to its claims and defenses because there was also ongoing litigation involving some of this documentation and these issues in other forums. The Fifth Circuit held that the existence and complexity of this other litigation excused the IRS and its counsel from conducting an investigation in this case. App. 46. The Fifth Circuit's holding appears to create a rule of inverse proportion under Tax Court Rule 33 (and by extension under FRCP 11): the more litigation there is, and the more complex the litigation is, the lower the obligation of litigants and their counsel to conduct a reasonable investigation -- for example, reading the documents on which the litigation is based -- and to have a reasonable basis in law and in fact for the positions taken in pleadings filed in the litigation. While there are certainly those who would welcome such an "inverse proportion" rule, Petitioner submits that this Court should correct this substantial error of law and rule strongly to the contrary and impose sanctions against the IRS and its counsel under Tax Court Rule 33 and 26 U.S.C. §6673.

CONCLUSION

For all of the reasons stated in this petition, *certiorari* should be granted.

Redding & Associates, P.C.

Date: July 23, 1998



Thomas E. Redding
Redding & Associates, P.C.
515 Post Oak Boulevard
Suite 500
Houston, Texas 77027
Telephone: 713/965-9244
Telecopier: 713/621-5227

APPENDIX TO
PETITION FOR WRIT OF CERTIORARI

TABLE OF CONTENTS

Verbatim reproductions of:

5. Order of the United States Tax Court (denying motion for sanctions) dated March 22, 1995 ..... App. 2

6. *Ragan v. Commissioner*, 69 T.C.M. (CCH) 2470 (1995) ..... App. 4

7. Order of the United States Tax Court (denying amended and renewed motion for sanctions) dated April 29, 1996 ..... App. 18

8. Tax Court Order (denying 1980 refund claim), unpublished, dated Jan. 23, 1997 ..... App. 25 - 34

9. *Ragan v. Commissioner*, 135 F.3d 329 (5th Cir. 1998) ..... App. 35

10. 11 U.S.C. §541(a) ..... App. 47

11. 26 U.S.C. §6402(a) ..... App. 49

12. 26 U.S.C. §6673 ..... App. 50

13. Texas Family Code §3.102(a) ..... App. 52

14. Fed. R. Civ. Proc. 11 ..... App. 53

15. Tax Court Rule 33 ..... App. 56

UNITED STATES TAX COURT
Washington, DC 20217

JACQUELINE RAGAN,	§	
	§	
Petitioner,	§	
	§	
v.	§	Docket No. 17119-90
	§	
COMMISSIONER OF INTERNAL REVENUE,	§	
	§	
	§	
Respondent.	§	

ORDER

On October 13, 1993, petitioner filed a motion for sanctions pursuant to Rule 33(b), Tax Court Rules of Practice and Procedure. Respondent has objected.

Rule 33 is entitled "Signing of Pleadings." Rule 33(b) describes the effect of the signature of counsel, or a party, on a pleading. Rule 33(b) also provides for the imposition of sanctions if a pleading is signed in violation of the rule.

Petitioner's motion is a complaint against respondent for the signature of respondent's counsel on the answer and other pleadings filed in this matter. Petitioner does not specific what "other" pleading she is speaking of. The record does not show any other pleadings by respondent. We will, thus, concern ourselves only with the answer. The gravamen of petitioner's complaint is that, first, in her answer, respondent denied virtually all of petitioner's assignments of error and then, subsequently, conceded that no deficiency would be asserted against petitioner.

Our inquiry is to what was reasonable, under the circumstances, at the time the answer was filed. See Bersteeg v. Commissioner, 91 T.C. 339, 342 (1988). We have considered carefully respondent's objection and, on the basis thereof, determine that respondent's answer was reasonable, under the circumstances, at the time it was filed. Respondent has set forth in her answer a chronology of events that make her answer reasonable, and petitioner has not rebutted the

conclusion of reasonableness to be drawn from respondent's objection.

On the premises stated, it is

ORDERED that petitioner's motion for sanctions is denied.

/signed/
James S. Halpern
Judge

Dated: Washington, D.C.
March 22, 1995

T.C. Memo. 1995-184

UNITED STATES TAX COURT

Jacqueline Ragan, Petitioner v.
Commissioner of Internal Revenue, Respondent

Docket Nos. 17119-90. Filed April 20, 1995.

Thomas E. Redding, 515 Post Oak Blvd., Houston, Tex., for the petitioner. Lillian D. Brigman, for the respondent.

Memorandum Opinion

HALPERN, Judge: Respondent has determined deficiencies, additions to tax, and additional interest with respect to petitioner's Federal income tax liabilities for the years 1980, 1981, and 1982. Apparently, the parties have settled or otherwise disposed of all issues raised by such determinations. This case has been submitted for decision without trial, pursuant to Rule 122, Tax Court Rules of Practice and Procedure. The parties agree that the issue for decision concerns a claim for refund raised by petitioner in the petition.

Facts stipulated by the parties are so found. The stipulation of facts filed by the parties and attached exhibits are incorporated herein by this reference.

Unless otherwise noted, all Rule references are to the Tax Court Rules of Practice and Procedure and all section references are to the Internal Revenue Code, as in effect for the years in issue.

Background

Residence

At the time the petition in this case was filed, petitioner resided in Houston, Texas.

Petition

In the petition, petitioner states: "Additionally, Taxpayer has pending a claim for refund of overpaid income taxes for the year 1980 which was timely filed as a form 1040X and which Taxpayer requests that this be considered as a part of this Petition." Petitioner also states: "The Commissioner erroneously determined that a tax refund of $50,695.31 paid on September 26, 1989 to the Trustee in Bankruptcy of Petitioner's husband, David Ragan's estate was

erroneous and if not erroneous the Commissioner should apply for a return of the money from the Trustee in bankruptcy to whom it was paid." In support of her claim for refund and with regard to the "erroneous" refund, petitioner avers the following:

> A. *1980 1040X.* Petitioner would assert that the 1980 1040X which was received by the Internal Revenue Service on August 1, 1985 and which, according to their very words "has not been processed" should be allowed in full as reported therein.
>
> B. *Erroneous Refund Paid.* Petitioner asserts that the refund that was paid in the amount of $50,695.31 on September 26, 1989 was paid to the Trustee in bankruptcy under cause number 85-00561 styled "In re: David J. Ragan, Debtor, Gina A. West, Trustee in the United States Bankruptcy Court, for the Eastern District of Kentucky, Lexington, Kentucky. Such money was never paid to Petitioner and if it was erroneous it would be a simple matter for the Commissioner to apply back to the Bankruptcy Court to seek a return of the funds and not to assert that Petitioner should have to pay the money back when the funds are being held by a Trustee under federal court supervision.

Among other prayers for relief, the petition contains the following: "The petitioner is entitled to a refund as shown on the 1980 1040X plus interest for the year 1980."

Answer

In the answer, respondent denies petitioner's claims and averments with regard to refunds, except that she admits that an erroneous refund of $50,695.31 paid on September 26, 1989, is being recovered "as a part of the statutory notice of deficiency."

Returns

Petitioner and her husband, David J. Ragan, made joint returns of income for their taxable (calendar) years 1980 through 1983.

Claim for refund

On June 17, 1985, petitioner and David J. Ragan filed with respondent a Form 1040X, Amended U.S. Individual Income Tax Return, for 1980, claiming a refund of $108,935 (the 1980 refund claim). The Form 1040X attributed the refund to a change in income for 1980 resulting from a net operating loss carryback to 1980 from

1983. By December 1985, respondent had not acted on the 1980 refund claim.

Husband's Bankruptcy

On August 6, 1985, David J. Ragan filed a voluntary petition in bankruptcy under chapter 11 of the Bankruptcy Code.

On December 11, 1985, David J. Ragan, as debtor-in-possession, initiated an adversary proceeding (the adversary proceeding) against the United States of America, Internal Revenue Service, by filing a complaint (the complaint) in the U.S. Bankruptcy Court, Eastern District of Kentucky (the Bankruptcy Court). The complaint asked the Bankruptcy Court to order the Internal Revenue Service to pay the 1980 refund claim and another refund to him. The United States timely answered and defended against the complaint. Among it defenses, the United States asserted a secured interest in any refund due the debtor and a right to offset any refund against the debtor's liabilities.

On September 19, 1986, Gina A. West was appointed trustee of the estate created when David J. Ragan filed his petition in bankruptcy (see sec. III. A. *infra*; the estate). Gina A. West was substituted for the debtor as plaintiff in the adversary proceeding. In 1989, W. Thomas Bunch was substituted for Gina A. West as trustee of the estate and as plaintiff in the adversary proceeding. Hereafter, without differentiation, both Gina A. West and W. Thomas Bunch will be referred to as trustee.

On September 8, 1989, the United States and the trustee settled the adversary proceeding. The United States agreed to amend its proofs of claim to withdraw those income tax claims to which the trustee objected; it conceded that a refund was due to the estate; it agreed that the amount of refund due pursuant to the 1980 refund claim was $108,935 plus interest. In light of the agreement between the United States and the trustee, on September 8, 1989, the Bankruptcy Court ordered a payment by the United States to the estate. The United States was ordered to present to the trustee within 10 days the amount that it believed was due the estate. The trustee was given 10 days to accept or object to the amount. If the trustee objected to the amount, the United States was ordered to pay to the estate the amount that it claimed was owed, "which in no event shall be less than the $108,935.00 plus interest from April 15, 1984 less the

amount shown on the second proof of claim for employment taxes in the amount of $53,000.00 and $9,151.04 plus interest and penalty, if any".

By letter dated September 18, 1989, pursuant to the Bankruptcy Court order of September 8, 1989, the United States notified the trustee of the amount that the United States believed was due the estate. Net of all setoffs asserted by the Internal Revenue Service, the amount was $50,695.31.

On September 26, 1989, the Internal Revenue Service paid $50,695.31 to the trustee.

On May 9, 1990, the trustee gave notice to all interested parties of his intent to seek approval to compromise the adversary proceeding. On May 21, 1990, the debtor filed an objection to that settlement. On July 9, 1990, a hearing was held, and on July 26, 1990, the Bankruptcy Court entered an order authorizing the trustee to compromise the adversary proceeding on the terms agreed to between the trustee and the Internal Revenue Service.

On December 4, 1990, the Bankruptcy Court entered an order upon the trustee's motion to approve the settlement of the remaining disputed issues in the adversary proceeding. Among other things, that order required:

> (1) That the trustee is due a refund in respect of the Debtor's 1980 federal income tax in the amount of $108,935.00, plus interest accruing according to law, of which the Internal Revenue Service has already refunded to the Trustee $50,711.19;
>
> (2) That the Internal Revenue Service has a right to setoff against the refund described in the preceding paragraph unpaid pre-petition employment taxes, penalties, and interest for the fourth quarter of 1984 and the first and second quarters of 1985, in the amount of $58,809.00, plus post-petition interest accruing according to law;
>
> (3) That, within six weeks after entry of this Order, the Internal Revenue Service will compute the net amount of the refund owed to the Debtor pursuant to paragraphs (1) and (2) of this Order, and will refund the balance to the Trustee;

Petitioner and David J. Ragan resided in Texas in 1980 and 1983.

The 1980 claim for refund is with regard to tax payments made from funds that were the wages of David J. Ragan. Such funds were the community property of petitioner and David J. Ragan.

Discussion

I. Introduction

The issue for decision concerns a claim for refund of overpayment of Federal income tax liability. Petitioner and her husband, David J. Ragan, made joint returns of income tax for their taxable (calendar) years 1980 through 1983. On June 17, 1985, they filed with respondent a Form 1040X, Amended U.S. Individual Income Tax Return, for 1980, claiming a refund of $108,935 (the 1980 refund claim). They claimed that they overpaid their 1980 Federal income tax by $108,935 as the result of a carryback of a net operating loss from 1983. The 1980 refund claim had not been processed by the time petitioner filed the petition herein, and petitioner timely raised the 1980 refund claim in the petition. Petitioner's taxable year 1980 is here in issue, and we have jurisdiction to find an overpayment for such year and determine the amount thereof. See sec. 6512(b)(1). As generally with other matters before this Court, petitioner bears the burden of proof. Rule 142(a).

Respondent has questioned how much of the 1980 claim for refund is at issue. It is true that, in her trial memorandum, petitioner does state that she now seeks a $50,695.31 refund paid to the trustee. Nevertheless, having considered carefully the petition, the Form 1040X by which the 1980 refund claim was made, the trial memorandum of petitioner, the postsubmission memoranda of petitioner, and the stipulation, we are satisfied that petitioner has raised, and continues to insist on, a refund (*i.e.*, an overpayment to which she is entitled) of one-half of the 1980 refund claim, viz, $54,467.50. We will decide that issue.

Finally, both the petition and the answer raise the issue of an erroneous refund of $50,695. In respondent's reply to petitioner's memorandum of law (respondent's reply), p. 12, respondent states:

> Contrary to petitioner's assertion, respondent does not admit that the refund paid to the Bankruptcy Trustee in David J. Ragan's bankruptcy was erroneous. The refund was described as erroneous

in the statutory notice in order to protect the Internal Revenue Service. No attempt has been made to recover it from petitioner.

We accept respondent's explanation and conclude that there is no issue with regard to an erroneous refund for us to decide.

II. Issues

Certain things are agreed by the parties. "Respondent agrees that at one point petitioner and David J. Ragan overpaid their income taxes for taxable year 1980 by $108,935.00." Respondent's reply p. 3. Respondent further agrees that, "under the community property laws of Texas, petitioner and her husband each owned a one-half interest in the * * * [1980 refund claim]". *Id.* at p. 4.

Respondent's objection to petitioner's claim of an overpayment to which she is entitled is crystalized as follows: "After payment of the refund to the Trustee in David J. Ragan's bankruptcy and crediting the setoffs pursuant to Court Order, that overpayment no longer exists." *Id.* at p. 3.

Petitioner's argument to the contrary is based principally on two points: One, petitioner's community property interest in the 1980 refund claim is a special kind of community property interest--"sole management and control community property"--which cannot be applied to the tax liability of any person other than petitioner. Two, the offsets must be disregarded.

For the reasons stated below, we reject petitioner's arguments and agree with respondent.

III. Sole Management and Control Community Property

A. *Bankruptcy Estate*

When David J. Ragan filed his petition in bankruptcy, he caused to be created an entity separate from himself, an "estate" (the estate). See Bankruptcy Code sec. 541(b). 11 U.S.C. (Bankruptcy Code) sec. 541(a) (1988). Among other things, the estate succeeded to "[a]ll interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is * * * under the sole, equal, or joint management and control of the debtor". Bankruptcy Code sec. 541(a)(2)(A).

There is no question (and petitioner does not argue) that, if the 1980 refund claim is community property "under the sole, equal, or joint

management" of David J. Ragan, it is includable in the estate pursuant to section 541 of the Bankruptcy Code. While conceding that her one-half interest in the 1980 refund claim is community property, petitioner argues that it is not community property "under the sole, equal, or joint management" of David J. Ragan:

> The Petitioner asserts that her interest in the overpayment is properly characterized as the Petitioner's sole management and control community property, and not the sole management and control property of her bankrupt spouse, or their equal or joint control community property. It is, therefore, specifically excluded from Section 541(a). [Petitioner's reply to respondent's memorandum of authorities p. 16.]

B. *Sole Management and Control Community Property*

1. Respondent's Position

Respondent concedes that, if petitioner's interest in the 1980 refund claim was her "sole management" community property, it was not part of the estate: "It is true that a spouse's earnings which are properly characterized as 'sole management' community property are exempt from the other spouse's creditors unless both spouses are liable by other rules of law." Respondent's reply p. 9. Nevertheless, respondent argues that petitioner has not proven that any part of the 1980 refund claim was her sole management community property or that other rules of law do not eliminate the exemption.

2. The Law of Texas

The law of Texas is important in determining whether petitioner's interest in the 1980 refund claim became property of the estate:

> The question whether an interest claimed by the debtor is "property of the estate" is a federal question to be decided by federal law; however, courts must look to state law to determine whether and to what extent the debtor has any legal or equitable interests in property as of the commencement of the case. *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L. Ed. 2d 136 (1979); *Matter of Jones*, 768 F.2d 923, 927 (7th Cir. 1985).
> * * *

In re Yonikus, 996 F.2d 866, 869 (7th Cir. 1993). For Federal income tax purposes, to determine interests in property, we also generally look to State law. *E.g., Massaglia v. Commissioner* [Dec. 23,864], 33

T.C. 379, 383 (1959) (question of whether taxpayer's interest in real property was community interest: "The existence of interests in real property is a matter of state law; the occasion and extent of their taxation by the Federal Government, a matter of Federal law."), affd. [61-1 USTC ¶ 9208] 286 F.2d 258 (10th Cir. 1961).

The Texas Family Code specifies whether community property is subject to (1) the sole management, control, and disposition of one spouse (sole management community property) or (2) the joint management, control, and disposition of both spouses (joint management community property). The rules are as follows:

> (a) During marriage, each spouse has the sole management, control, and disposition of the community property that he or she would have owned if single, including but not limited to:
>
> (1) personal earnings;
>
> (2) revenue from separate property;
>
> (3) recoveries for personal injuries; and
>
> (4) the increase and mutations of, and the revenue from, all property subject to his or her sole management, control, and disposition.
>
> (b) If community property subject to the sole management, control, and disposition of one spouse is mixed or combined with community property subject to the sole management, control, and disposition of the other spouse, then the mixed or combined community property is subject to the joint management, control, and disposition of the spouses, unless the spouses provide otherwise by power of attorney in writing or other agreement.
>
> (c) Except as provided in Subsection (a) of this section, the community property is subject to the joint management, control, and disposition of the husband and wife, unless the spouses provide otherwise by power of attorney in writing or other agreement. [Tex. Fam. Code Ann. sec. 5.22 (West 1993) (sec. 5.22).]

Claims to income tax refunds are not included in the list set forth in section 5.22(a). By the terms of section 5.22(a), however, that list is not exclusive. We are thus presented with a question of statutory interpretation. We must ascertain the law of Texas as the highest

court in the State would apply it. See *Commissioner v. Estate of Bosch* [67-2 USTC ¶ 12,472], 387 U.S. 456, 465 (1967).

We need not inquire with regard to the universe of claims to income tax refunds. Petitioner has stated: "[I]t is undisputed that the funds from which the tax payments were made were the wages of David J. Ragan". Memorandum of law for petitioner p. 14. We have found accordingly. Petitioner has not proposed, nor have we made, any finding with regard to (1) the income reported for 1980 or (2) the property that gave rise to the net operating loss that caused the overpayment for 1980. We thus need inquire only whether any portion of a claim to a refund of Federal income tax payments made from wages (1) earned by a spouse and that are (2) community property of both spouses is the sole management community property of the other spouse.

We have found no case of a Texas court that is on point. A decision of the United States Bankruptcy Court, however, is instructive: *In re Bathrick*, 1 Bankr. 428 (Bankr. S.D. Tex. 1979). In that case, the Bankruptcy Court was called upon to apply Texas law. A proceeding had been initiated by a trustee in bankruptcy asserting that a Federal income tax refund that was owed jointly to the bankrupt and his wife (not a bankrupt) vested in the trustee of the husband's estate upon the filing of the husband's voluntary petition in bankruptcy. The bankruptcy court found that the bankrupt and his wife had made a joint return of income for 1975 (the year preceding the husband's bankruptcy) and that virtually all of the income reported by them for that year constituted earnings of the husband. The court also found that the refund was generated largely by deductions for capital and real estate losses. There is no finding with regard to ownership of the property giving rise to the losses. The court applied section 5.22 as follows:

> Personal earnings, while community property, are by statute subject to the sole management, control and disposition of the spouse who earned them. Tex. Family Code Ann. section 5.22 (1975). As previously stated, virtually all of the income reported on the 1975 tax return was earned by * * * [the husband]; therefore, the refund, as excess payments of personal earnings, would be community property under the sole control, management and disposition of * * * [the husband]. [*Id.* at 430.]

The court concluded that the refund in question passed to the

bankruptcy estate on the date the bankrupt filed his petition. *Id.* at 432. The court's finding that the refund in question was sole management community property of the husband necessarily precludes a finding that the same property was sole management community property of the wife.

The bankruptcy court in *In re Bathrick* failed to distinguish between the bankrupt's personal earnings, which gave rise to the refund ("as excess payments of personal earnings"; *id.* at 430), and the refund itself. The court reasoned that, since the bankrupt's personal earnings constituted sole management community property of the husband, so did the resulting refund. Here, petitioner would distinguish between the tax payments that gave rise to the refund and the refund itself: "The income and refund are separate funds, each with different characterizations as to *type of community property* for Texas Law." Memorandum of law for petitioner p. 18. Petitioner looks to section 6402(a) (overpayment creditable for benefit of, or refundable to, the person who made the overpayment), certain case law, *e.g.*, *Hathaway v. United States*, 93-1 USTC ¶ 50,285, 88091 (W.D. Wash. 1993) ("case law overwhelmingly establishes that overpayments by married couples are apportionable to each spouse to the extent that he or she contributed to the overpaid amount"), and certain published rulings of respondent, *e.g.*, Rev. Rul. 80-7, 1980-1 C.B. 296, 297 ("In a community property state, each spouse is considered the recipient of one-half of the wages upon which taxes are withheld and thus is entitled to a credit for one-half of the taxes that are withheld.") to support the proposition that petitioner has a certain control over her one-half interest in the 1980 refund claim that makes her interest *her* sole control community property. We disagree.

The reasoning of the Bankruptcy Court in *In re Bathrick, supra*, is persuasive. On the facts before us (like those before the Bankruptcy Court) the refund clearly is closely related to the personal earnings of the bankrupt spouse, which, without doubt, constitute property described in section 5.22(a). Petitioner has not alleged that such personal earnings lost their character as sole management community property of David J. Ragan by virtue of having been mixed or combined with sole management community property of petitioner. See sec. 5.22(b). Moreover, petitioner ignores the language of section 5.22(a) that provides that, "[d]uring marriage, each spouse has the sole management, control, and disposition of *the community property that he or she would have owned if single*". (Emphasis added.) Any

right of petitioner under section 6402(a) to a portion of the 1980 refund claim results solely from the status of David J. Ragan's wages (from which the 1980 taxes were paid) as community property. Put another way, but for the status of David J. Ragan's wages as community property, petitioner has failed to prove any fact that would lead to the conclusion that she is entitled to a refund of any portion of the overpayment that gave rise to the 1980 refund claim. In a nutshell, petitioner has failed to prove that the refund claim is community property that she would have owned if single.

3. Conclusion

Accordingly, we hold that no part of the 1980 refund claim constitutes sole management community property of petitioner within the meaning of section 5.22(a). We further hold that the entirety of the 1980 refund claim constitutes sole management community property of David J. Ragan within the meaning of section 5.22(a).

C. *Property of the Estate*

1. Introduction

It is insufficient for us to hold merely that the entirety of the 1980 refund claim constitutes sole management property of David J. Ragan under the laws of Texas. We also must determine whether all, or any portion, of the 1980 refund claim became property of the estate within the meaning of section 541(a) of the Bankruptcy Code.

2. Section 541(a) of the Bankruptcy Code

Section 541(a)(1) of the Bankruptcy Code defines the estate broadly as including "all legal or equitable interests of the debtor in property as of the commencement of the case". The bankrupt's right to a tax refund is property of the estate. *In re Doan*, 672 F.2d 831, 832-833 (11th Cir. 1982). The entirety of a refund that constitutes sole management community property of the bankrupt under Texas law is property of the estate of that bankrupt. See *In re Barnes*, 14 Bankr. 788, 790 (Bankr. N.D. Tex. 1981) ("By joining in the filing of a joint petition, Mrs. Barnes relegated all her interests in community property under her sole management, including the income tax refund, to the property of the estate."); *In re Bathrick*, 1 Bankr. 428 (Bankr. S.D. Tex. 1979) (under Bankruptcy Act, predecessor to the Bankruptcy Code, tax refund that was sole management community property passed to the bankruptcy trustee on

the date bankrupt filed his petition).

3. Conclusion

In its entirety, the 1980 refund claim became property of the estate when David J. Ragan filed his petition in bankruptcy.

IV. Offsets

A. *Introduction*

In her trial memorandum, under the heading: "Summary of Facts", respondent states:

> The settlement between the United States and trustee provided that the debtor's 1980 federal income tax refund of $108,935.00 (plus interest) would be paid to the trustee in David J. Ragan's bankruptcy and that the I.R.S. had the right to setoff certain unpaid employment taxes due from David J. Ragan from the refund payment.

Petitioner challenges respondent's right to raise "its affirmative defense of offsets." Memorandum of law for petitioners p. 21. Petitioner claims that respondent raised that defense for the first time in her trial memorandum. *Id.* Petitioner cites Rule 39 ("Pleading Special Matters") and states: "Respondent has neither properly pled the right of offset nor introduced any evidence to carry its burden of proof." (*Id.* at 22.)

Respondent's response is simple:

> Petitioner misconstrues respondent's position. Respondent has not raised an affirmative defense of offsets, or setoffs, in bankruptcy parlance. Nor is such a defense required. Respondent's position is that this Court lacks jurisdiction over the $108,935.00 of David J. Ragan's bankruptcy. Setoffs to that $108,935.00 are likewise not within this Court's jurisdiction. [Respondent's reply p. 9.]

B. *Analysis*

We agree with respondent.

We have held that, in its entirety, the 1980 refund claim became property of the estate when David J. Ragan filed his petition in bankruptcy. Moreover, we have found that, on December 4, 1990, the Bankruptcy Court entered an order (the order) providing, among

other things:

> (1) That the trustee is due a refund in respect of the Debtor's 1980 federal income tax in the amount of $108,935.00, plus interest accruing according to law, of which the Internal Revenue Service has already refunded to the Trustee $50,711.19;
>
> (2) That the Internal Revenue Service has a right to setoff against the refund described in the preceding paragraph unpaid prepetition employment taxes, penalties, and interest for the fourth quarter of 1984 and the first and second quarters of 1985, in the amount of $58,809.00, plus post-petition interest accruing according to law;
>
> (3) That, within six weeks after entry of this Order, the Internal Revenue Service will compute the net amount of the refund owed to the Debtor pursuant to paragraphs (1) and (2) of this Order, and will refund the balance to the Trustee;

That order is consistent with section 542 of the Bankruptcy Code, which provides in pertinent part:

> an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

Section 553 of the Bankruptcy Code provides the circumstances under which a creditor of the bankrupt may offset a mutual debt owing by such creditor to the bankrupt against a claim of such creditor against the bankrupt.

Jurisdiction over matters arising under the Bankruptcy Code is governed by 28 U.S.C. secs. 157 and 1334. Pursuant to that statutory authority, the Bankruptcy Courts, upon delegation from the District Courts, have jurisdiction over all bankruptcy cases. The Bankruptcy Courts, as units of the District Courts, have *exclusive* jurisdiction over all property of the bankrupt and the estate:

> The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of commencement of such case, and of property of the estate. [28 U.S.C. sec. 1334(d).]

The setoff contemplated in the second paragraph of the order involves a disposition of the property of the estate. We have no jurisdiction with regard either to such property or such setoff. 28 U.S.C. sec. 1334(d).

C. *Conclusion*

The objection to a claim of offset raised by petitioner does not involve an affirmative defense that respondent has failed properly to plead. Instead it involves a question concerning the jurisdiction of this Court. "A jurisdictional issue can be raised by either party or the Court sua sponte at any stage of the proceedings." *Smith v. Commissioner* [Dec. 47,113], 96 T.C. 10, 13-14 (1991). Petitioner's claims with regard to offset fail.

V. Conclusion

On the premises stated, petitioner has failed to carry her burden of showing any overpayment for 1980 to which she is entitled, and we so find. We hold that she is entitled to no credit or refund with regard thereto.

Decision will be entered under Rule 155.

UNITED STATES TAX COURT
Washington, DC 20217

JACQUELINE RAGAN,	§	
	§	
Petitioner,	§	
	§	
v.	§	Docket No. 17119-90
	§	
COMMISSIONER OF INTERNAL REVENUE,	§	
	§	
	§	
Respondent.	§	

ORDER

On December 28, 1995, petitioner filed "Petitioner's Amended Renewed Motion for Sanctions Pursuant to Tax Court Rule 33 and Internal Revenue Code Section 6673" (the present motion). Respondent has objected.

Previously, by order dated March 22, 1995 (the March 22 order), we had denied "Petitioner's Motion for Sanctions" (the previous motion), by which petitioner had requested the imposition of sanctions against respondent pursuant to Rule 33, Tax Court Rules of Practice and Procedure. In the March 22 order, we pointed out that Rule 33 is concerned with pleadings and addressed ourselves to the answer, the only pleading made by respondent. We concluded that the answer was reasonable at the time it was filed. On that basis, we denied the previous motion.

The present motion asks for sanctions under both Rule 33 and section 6673. We will address those requests separately.

Unless otherwise noted, all section references are to the Internal Revenue Code in effect for the years at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Rule 33

In the present motion, petitioner justifies her requests for sanctions on the grounds that (1) the answer and respondent's response to the previous motion (the response) have no basis in fact or law and (2) particularly with respect to the response, it is based on perjury and

false evidence.

We are reluctant at all to consider the present motion as it relates to Rule 33. A substantial portion of the present motion is devoted to detailing purported deficiencies in the response. The response was filed at the call of the trial in this case, on October 25, 1993. The March 22 order, which disposes of the previous motion, was issued on March 22, 1995. In the interim, petitioner did not seek leave to file a reply to the response. Also, petitioner waited until October 2, 1995, to renew her motion for sanctions (on October 2, 1995, we ledged petitioner's renewed motion for sanctions). Petitioner has not moved expeditiously to object with respect to either the response or the March 22 order. Cf. Rule 161 (motion for reconsideration of the March 22 order. Cf. Rule 161 (motion for reconsideration of an opinion or finding shall be made within 30 days). Nevertheless, because of the serious nature of the charges with respect to the response made by petitioner, we will not refuse to consider the present motion on the ground that it is untimely.

With respect to the answer, the present motion is founded on an assertion similar to that underlying the previous motion: viz, that respondent had no basis for bringing this case. But for the claim of perjury and false evidence, petitioner has failed to set forth grounds that warrant a reconsideration of the March 22 order. With respect to the claim that the response is based "almost completely" on perjury and false evidence, the Court agrees with respondent that, although the response contains several errors, those errors are insignificant and the response remains well grounded in fact and supported by law.

In the present motion, petitioner refers to the "perjurious Affidavit of Teresa Barnett" (the Barnett affidavit), which was attached to the response. Petitioner describes the Barnett affidavit as containing "multiple instances of perjury" and complains that Barnett lied to the Court. Discussion of the Barnett affidavit occupies a majority of the numbered paragraphs of the present motion. We have examined the instances of misinformation complained of by petitioner in the present motion, and we agree with respondent that petitioner has exaggerated the extent and consequence of errors made in the Barnett affidavit. In particular, we have examined the notice of deficiency issued to petitioner and have compared it to Ms. Barnett's summary of the reasons for disallowance of certain partnership losses, viz, the losses from R & H Associates, Salmonella Research and

Development Group, and Dot Mining Joint Venture Partnership. We can see how Ms. Barnett may have arrived at a partially erroneous explanation, incorporating an explanation including Government securities trading. Particularly since the erroneous explanation only added to an otherwise correct explanation, we see no great harm to petitioner. We agree with respondent that: "Petitioner is attempting to make a mountain out of a molehill."

In the present motion, petitioner also focuses on a memorandum comprising part of exhibit B to the response, which, petitioner claims, "gives the lie" to respondent's whole case. Simply put, we disagree with petitioner that that memorandum demonstrates that there was no basis for respondent's case with respect to petitioner.

In sum, petitioner has not convinced us that the response is based on perjury and false evidence. Petitioner has not even established a prima facie case, which would justify a hearing. In fact, petitioner's charges strain the limits of permissible advocacy and cause us to suspect that petitioner improperly may be striving to delay this case.

As it respects Rule 33, we will deny the present motion.

Section 6673

Section 6673(a) is applicable to Tax Court proceedings. It provides:

(1) Procedures instituted primarily for delay, etc.

Whenever it appears to the Tax Court that--

(A) proceedings before it have been instituted or maintained by the taxpayer primarily for delay,

(B) the taxpayer's position in such proceeding is frivolous or groundless, or

(C) the taxpayer unreasonably failed to pursue available administrative remedies,

the Tax Court, in its decision, may require the taxpayer to pay to the United States a penalty not in excess of $25,000.

(2) Counsel's liability for excessive costs. Whenever it appears to the Tax Court that any attorney or other person admitted to practice before the Tax Court has multiplied the proceedings in any case unreasonably and vexatiously, the Tax

Court may require--

> (A) that such attorney or other person pay personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct, or
>
> (B) if such attorney is appearing on behalf of the Commissioner of Internal Revenue, that the United States pay such excess costs, expenses, and attorneys' fees in the same manner as such an award by a district court.

Petitioner moves for sanctions pursuant to section 6673. Petitioner, however, has failed clearly to set forth her grounds for such sanctions or, indeed, even to demonstrate that she understands the substance of that provision. The present motion addresses both Rule 33 and section 6673 without distinction or particularization. Petitioner has filed a single memorandum of law (petitioner's memorandum) in support of the present motion and in support of another motion ("Petitioner's Amended Motion for Attorney's Fees and Costs under Internal Revenue Code Section 7430"). In petitioner's memorandum, she states: "The Court may award sanctions under §6673 against a party for asserting a position that is frivolous or for maintaining a proceeding for purposes of delay." By that statement, petitioner appears specifically to be invoking section 6673(a)(1). By its terms, however, section 6673(a)(1) is applicable only against taxpayers. It has no application to respondent. Section 6673(a)(2), on the other hand, which deals with counsel's liability for excessive costs, is applicable to respondent's counsel. We will treat petitioner's motion for sanctions pursuant to section 6673 as a motion for excessive costs pursuant to section 6673(a)(2).

Petitioner's failure to particularize her grounds in support of her section 6673(a)(2) motion makes it difficult for us address her complaint. Petitioner, however, must bear the risk that we will be unable to distill out of her compound documents any appropriate grounds to support her section 6673(a)(2) motion. Rule 50 imposes on a party moving for an order the duty to "state with particularity" the grounds for the order. As stated, petitioner has failed to do so. Moreover, we are not helped by claims such as the following, found in petitioner's memorandum:

> Based on reported cases, Respondent's monstrous abuses of power have become standard operating procedure for the IRS;

> an agency that evidently views itself as beyond any earthly power including the courts, the Congress, the law, and all fundamental human morality. [Ps br. 3]

Section 6673(a)(2) allows excessive costs to be imposed against the United States when an attorney appearing on behalf of the Commissioner has multiplied the proceedings in any case unreasonably and vexatiously. This Court first interpreted section 6673(a)(2) in Harper v. Commissioner, 99 T.C. 533 (1992), in which the taxpayer's attorney was sanctioned for unreasonably and vexatiously multiplying the proceedings. The taxpayer's attorney handed over one document at a time for copying in violation of the Court's order, failed to comply with a subsequent order to produce documents, filed a motion for summary judgment at calendar call, and made tax-protestor type arguments.

In contrast to Harper, respondent's counsel have complied with all orders in this case and have not made frivolous, baseless arguments.

In the preamble to the present motion, petitioner alleges that respondent's answer and the response are frivolous and undertaken merely for delay. Respondent's counsel were of course involved with the answer and response. We dealt with the substance of petitioner's complaints with respect to the answer and response in the first portion of this order and found those complaints to be baseless. We will not repeat that discussion here.

Petitioner complains that one of respondent's counsel, Lillian D. Brigman (Brigman), did not consent to depositions of Special Agents Rodriguez and Sergeant and certain others and, therefore, prolonged these proceedings. In support of that allegation, petitioner offers a letter from Brigman dated February 4, 1994, which refers to petitioner's counsel's letter of January 25, 1994. In the February 4 letter, Brigman refuses to consent to the depositions, making reference to Rule 74(a) and stating her belief that the requested discovery would not be timely. Rule 70(a)(2) (which is referred to in Rule 74(a)) deals with time for discovery and requires leave of court for the depositions requested by petitioner. We conclude that Brigman's refusal to consent to the depositions was reasonable.

Petitioner has failed to set forth grounds justifying the imposition of excessive costs against the United States under section 6673(a)(2)(B). By the present motion, petitioner asks for discovery

to further develop those grounds. Petitioner has failed to convince us that such discovery is deserved, and we will grant no leave for any discovery.

Indeed, when we compare the courses of conduct of respondent's counsel and petitioner's counsel, we conclude that it is petitioner's counsel that may have unreasonably and vexatiously multiplied these proceedings. Attached to respondent's notice of objection to the present motion is a copy of a letter from respondent offering to concede the case against petitioner. That letter is dated July 19, 1993. That letter predates the previous motion and petitioner's requests for the discovery discussed above. Subsequently, we decided petitioner's claim for an overpayment, but we decided it adversely to petitioner. We entered decision on September 1, 1995, but, pursuant to petitioner's motion, we vacated that decision to consider this motion and another motion, a motion for attorney's fees that, otherwise, would have been untimely. We recently received from petitioner a motion to allow petitioner to file a reply to respondent's objections to petitioner's amended motions for fees and sanctions (which we will deny). Jacqueline Ragan may genuinely be upset with the Internal Revenue Service and may have decided to spare no cost in seeking relief. Alternatively, her attorneys may have been the driving force in the continuation of this case after respondent agreed to concede it, or Jacqueline and her attorneys, together, may think that, no matter what the merit of their complaints, the Court will award Jacqueline something. We do not know whether any of those, or some other, is a correct version of events. Without a complaint from respondent, however, we will not at this time pursue section 6673 with respect to petitioner or her counsel.

In the present motion, petitioner requests hearings on petitioner's "§7430 and sanctions motions". Petitioner's request for a hearing for purposes of section 7430 is not germane to the present motion, and we will ignore it (petitioner has filed a separate motion under section 7430). For the same reasons that we denied leave to conduct further discovery, we will hold no hearings on the claims for sanctions made in the present motion.

On the premises stated, it is

ORDERED that petitioner's amended renewed motion for sanctions pursuant to Tax Court Rule 33 and Internal Revenue Code section 6673 is denied.

/signed/
James S. Halpern
Judge

Dated: Washington, D.C.
April 29, 1996

UNITED STATES TAX COURT
Washington, DC 20217

JACQUELINE RAGAN,	§	
	§	
Petitioner,	§	
	§	
v.	§	Docket No. 17119-90
	§	
COMMISSIONER OF INTERNAL REVENUE,	§	
	§	
Respondent.	§	

ORDER AND DECISION

Introduction

On December 28, 1995, petitioner filed Petitioner's Amended Motion for Attorney's Fees and Costs under Internal Revenue Code Section 7430 (the motion).[3] Respondent has filed a notice of objection (the objection) and a supplemental objection. Petitioner has filed a response to the supplemental objection (the response). Petitioner has filed numerous affidavits in support of the motion. On April 29, 1996, we ordered petitioner to file additional affidavits providing detailed summaries of the dates, times, nature, and cost of the services performed in connection with the instant case by each of petitioner's attorneys and those in the attorneys' respective offices or otherwise under their direction (collectively, the additional affidavits).

Respondent determined deficiencies, additions to tax, and additional interest with respect to petitioner's Federal income tax liabilities for the years 1980, 1981, and 1982. The parties settled or otherwise disposed of all issues raised by such determinations. One issue, however, raised in the petition was submitted for decision without trial. That issue involved a claim for refund. That issue was decided adversely to petitioner. Ragan v. Commissioner, T.C. Memo. 1995-184.

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[3] Unless otherwise indicated, all section references herein ...

At all times relevant to the instant case, petitioner's husband, David Ragan, was involved in various civil and criminal matters, including a civil case filed against him in 1984, a bankruptcy proceeding instituted by him in 1985, a criminal proceeding instituted against him in 1989, and a civil case filed by him in 1995 (collectively, the David Ragan matters). At various times, some of the attorneys that represented David Ragan in the David Ragan matters also represented petitioner in connection with the matters discussed herein.

Attorney's Fees

Background

In the motion, petitioner requests an award of attorney's fees and costs of at least $154,105.85 or, alternatively, an award in such amount as the Court shall determine.

Section 7430 provides that a prevailing party may be awarded a judgment for reasonable litigation costs incurred in connection with a court proceeding. Rule 232 provides a rule relevant to the disposition of a claim made pursuant to section 7430.

In general, a prevailing party may be awarded reasonable litigation costs if the party has: (1) exhausted her administrative remedies, (2) established that respondent's position in the proceeding was not substantially justified, (3) substantially prevailed with respect to the amount in controversy or with respect to the most significant issue or set of issues presented, (4) established that its net worth did not exceed a specified amount at the time the proceeding was commenced, and (5) has not unreasonably protracted the Court proceeding. Sec. 7430.

Respondent's Arguments

Respondent agrees that petitioner has: (1) exhausted her administrative remedies, (2) substantially prevailed, and (3) met the net worth requirement. Respondent also agrees that she lacked substantial justification with respect to the following adjustments to tax, additions to tax, and penalties set forth in the statutory notice of deficiency issued to petitioner (collectively, the uncontested issues):

1. Schedule F farm/horse breeding losses.
2. Gains, losses, deductions, and income relating to trading in government securities.

3. Additions to tax asserted under sections 6653(a), 6653(a)(1), 6653(a)(2), 6651(a), 6621(c), and 6661 (except to the extent related to the DOT Mining Venture and Salmonella Research and Development Group issues).

Respondent argues that she possessed substantial justification with respect to the following issues (collectively, the contested issues):

1. Refund made to bankruptcy trustee.
2. DOT mining Joint Venture.
3. Salmonella Research and Development Group.

Respondent argues that the refund issue was decided in her favor by the Court in Ragan v. Commissioner, supra, and that the two other issues were settled in her favor.

Respondent also argues that (1) the amounts of costs claimed by petitioner are wholly unreasonable and (2) petitioner unreasonably protracted the instant litigation after September 29, 1992.

Burden of Proof

Petitioner bears the burden of proving the elements of her claim for litigation costs to the extent not conceded by respondent. Rule 232(e). That is, petitioner must prove the following: (1) the position of respondent was not substantially justified, (2) the amount of the claimed costs is reasonable, and (3) she (petitioner) has not unreasonably protracted the instant proceedings. Rule 232(e). With respect to the uncontested issues, petitioner need not prove that first element.

Substantial Justification with Respect to the Contested Issues

Petitioner has failed to establish that respondent's position with respect to the contested issues was not substantially justified. Petitioner has submitted no affidavits or otherwise averred any facts that would contradict respondent's assertion that all of the contested issues were either decided or settled in respondent's favor. Therefore, we conclude that, with respect to the contested issues, respondent's position was substantially justified.

Reasonable Litigation Costs with Respect to the Uncontested Issues

As to the uncontested issues, petitioner has failed to show that she can prove the reasonableness of her primary claim for attorney's fees and costs of at least $154,105.85. Petitioner has not supported

through the additional affidavits the fees and costs that form the basis of her original, primary claim for $154,105.85, which fees and costs are detailed in the affidavit of Bruce Rose attached as Exhibit A to the motion (Exhibit A). We need go no further than to point out that, in Exhibit A, Mr. Rose claims fees incurred for his own work of $57,875, while in his additional affidavit, he provides justification with respect to only $35,050 of fees. A shortfall in excess of $20,000 is sufficient to us to conclude that petitioner cannot prove the reasonableness of her claim for $154,105.85.

Petitioner's alternative claim is for an award in such amount as the Court shall determine. To make that determination, we consider principally the additional affidavits.

Additional Affidavit of Thomas E. Redding

Thomas E. Redding is an attorney admitted to practice before this Court. By his affidavit, Mr. Redding states that he cannot determine the amount of time that he and his employees devoted to particular aspects of the instant case. Mr. Redding did not submit a detailed summary in the form requested by the Court in our order of April 29, 1996. Mr. Redding concludes that 15 hours is a "fair allocation" of time spent on those aspects of the instant case for which he thinks litigation costs can be claimed. We agree with respondent that that rough estimate is inadequate. Petitioner cannot receive compensation for any work done on any issue upon which she did not prevail, even though she may have prevailed on other issues. Powers v. Commissioner, 15 F.3d 34, 35 (5th Cir. 1995). Further, petitioner cannot receive compensation for work performed in connection with issues that respondent was "substantially justified" in pursuing. See, e.g., Wolf v. Commissioner, 74 F.3d 1235 (4th Cir. 1996), affg. per curiam, T.C. Memo. 1994-93 (approving an issue-by-issue approach). Mr. Redding worked primarily on the refund issue that the Court decided in respondent's favor. Petitioner has failed to show that she can adequately prove an allocation of Mr. Redding's time to (1) issues that respondent did not win or (2) issues with respect to which respondent's position was not substantially justified. We agree with respondent's analysis set forth in the portion of the supplemental objection that addresses the affidavit of Thomas E. Redding. Petitioner has failed to show that she can prove that any fees paid to Mr. Redding are allocable to an issue upon which petitioner may base a claim for recovery under section 7430. We award no judgment for

litigation costs incurred in connection with the work of Mr. Redding.

Additional Affidavit of Bruce Rose

Bruce Rose is an attorney who was admitted to practice before this Court on June 14, 1993. Mr. Rose made an appearance in this case on January 31, 1994. In his additional affidavit, Mr. Rose details the period between November 13, 1990, and November 24, 1993, during which he performed services giving rise to a portion of petitioner's claim for litigation costs. Mr. Rose lists a total of 138 hours. None of those hours postdate his appearance in this case. Moreover, although some of the 8.75 hours that he expended between February 25, 1993, and November 24, 1993, postdate his admission to practice before this Court, we cannot tell how much of that time gives rise to recoverable litigation costs because Mr. Rose's additional affidavit fails to comply with our order of April 29, 1996. Furthermore, in his additional affidavit, Mr. Rose states that, in 1990, after petitioner received the notice of deficiency upon which this case is based, he (Mr. Rose) advised David Ragan that he did not have the tax law background to take on the instant case and that he was otherwise occupied with other legal maters. While it is possible that some or all of the services performed by Mr. Rose before he entered an appearance in this case may give rise to attorney's fees within the meaning of section 7430(c)(1)(iii) (e.g., he could have ;drafted the petition or, after the petition was filed, he could have assisted an attorney who had entered an appearance), we are not convinced that any of the time listed by Mr. Rose gives rise to such fees. We are persuaded by the argument made by respondent in the supplemental objection and, in substance, we adopt that argument here. We award no judgment for litigation costs incurred in connection with the work of Mr. Rose.

Affidavit of James C. Mulder

James C. Mulder is an attorney admitted to practice before the Court. He prepared and filed the petition in this case. His affidavit shows that, with respect to the instant case, he performed 33.75 hours of service between May 1, 1990, and June 4, 1993. His affidavit fails to comply with our order of April 29, 1996, in that it fails to provide the detail required by that order. Among other things, we are unable to determine what portion of the time expended by Mr. Mulder relates to issues for which respondent did not have substantial justification. We conclude that petitioner is unable to prove those

facts. Because we do believe that Mr. Mulder did perform some services that give rise to compensable attorney's fees, we make our best estimate and allow a claim for 10 hours of service. See Golsen v. Commissioner, 54 T.C. 742, 757 (1970), affd. 445 F.2d 985 (10th Cir. 1971). We will award a judgment for litigation costs incurred in connection with the work of Mr. Mulder in the amount of $980: We value Mr. Mulder's work at the rate of $92 an hour, without an adjustment for any special factor other than the cost of living. Powers v. Commissioner, 43 F.3d 172, 182-184 (9th Cir. 1993). We will conclude in our award $60 for the fee incurred in filing the petition in the instant case.

Affidavit of Jonathan Chase McEvoy, Jr.

Jonathan Chase McEvoy, Jr. is a shareholder in McEvoy & Co., a professional corporation (McEvoy & Co.). McEvoy & Co. provides accounting services. Mr. McEvoy's affidavit shows that personnel of McEvoy & Co. performed 829 hours of service in connection with the instant case. Petitioner asks that the Court allow reimbursement of the $96,659 paid to McEvoy & Co. for the period between April 19, 1990, and December 22, 1993. That amount of money represents the sum of $72,445.40 in fees plus expenses of $22,213.60. Mr. McEvoy states that those costs qualify as reasonable litigation costs within the meaning of section 7430(c)(1)(B)(ii).[4]

In the objection and supplemental objection, respondent sets forth reasons why none of the fees or expenses claimed on account of the services performed by McEvoy & Co. should be allowed as an award of litigation costs. We substantially agree with respondent's reasons, and adopt her analysis as our own. We set forth here only certain highlights of that analysis. First, we are unable to tell which portion of the McEvoy & Co. work related exclusively to this case. Indeed, in his affidavit, Mr. McEvoy states: "The fees and expenses for which reimbursement under IRC Sec. 7430, to the extent allocated to the government securities matter, could reasonably be allocated between

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[4] Mr. McEvoy's claim for fees exceeds by over $10,000 the claim made for those services by petitioner in the affidavit of Bruce Rose attached to the motion. The claim for expenses also exceeds the claim for expenses made in that affidavit. Petitioner has not asked for leave to amend the motion to increase her claim. In light of the disposition we make with respect to petitioner's claim regarding the services performed by Mr. McEvoy and McEvoy & Co., that failure is of no consequence.

the J. Ragan Tax Court case and the civil litigation [i.e., certain of the David Ragan matters]." McEvoy affidavit ¶27. Mr. McEvoy also states that much of the work that McEvoy & Co. performed necessarily overlapped with certain of the David Ragan matters. McEvoy affidavit ¶10. A clear showing that the claim for litigation costs is related to the case at bar is necessary to recover litigation costs. Guyan Oil Co. v. Commissioner, T.C. Memo. 1988-486; see also Mearkle v. Commissioner, 90 T.C. 1256, 1261 (1988) ("We do not find it appropriate to fully reimburse litigation costs in one case which were incurred for the purpose of other cases as well, some of which may have already been in litigation. [Footnote omitted.]"), revd. and remanded 838 F.2d 880 (6th Cir. 1988). Second, reasonable litigation costs, as defined in section 7430(c)(B)(ii), do not include the fees of an accounting firm not working under the direction or employ of an individual authorized to practice before the Court. Guyan Oil Co. v. Commissioner, supra. In his affidavit, Mr. McEvoy states that his efforts in this case were, at all times, performed under the direction of petitioner's counsel. Mr. McEvoy states that his efforts were at first performed under the direction of James C. Mulder and were subsequently performed under the direction of Kelly Williams and Bruce Rose. McEvoy affidavit ¶¶1, 25. McEvoy & Co. started to perform services for petitioner on April 19, 1990. Mr. Mulder's affidavit indicates that Mr. Mulder enlisted the services of Mr. McEvoy on six occasions between January 28, 1991, and April 12, 1991. Mr. Mulder's affidavit indicates that he and Mr. McEvoy worked together for no more than 8.5 hours during that time period. Petitioner has failed to provide an affidavit by Mr. Williams. Mr. Williams' name does appear in Mr. McEvoy's affidavit, but we are not convinced that Mr. Williams supervised Mr. McEvoy or that they worked together on any issue for which compensation can be claimed. One entry is with respect to a meeting with "D. Ragan"; other entries clearly are in connection with the refund issue that petitioner lost. Mr. Rose was not admitted to practice before this Court until June 14, 1993. That date is more than 3 years after McEvoy & Co. began working for petitioner. Mr. Rose's additional affidavit does contain one entry mentioning a conference with Mr. McEvoy on April 23 or 24, 1992, that lasted 1.75 hours. That conference occurred prior to the date on which Mr. Rose was admitted to practice before this Court. Finally, Mr. McEvoy's summaries are short on detail. Mr. McEvoy allocates approximately 102 hours of service between August 17, 1993, and the end of 1993

to litigation support services. Mr. McEvoy's explanation of that item (Exhibit 1A, Explanation of Matter H) is vague. Petitioner has failed to show that none of that litigation support related to (1) issues as to which petitioner did not prevail or (2) issues with respect to which respondent possessed substantial justification.

Petitioner has failed to show that any significant portion of the fees or expenses set forth in Mr. McEvoy's affidavit represent the reasonable cost of any study, analysis, engineering report, test, or project necessary for the preparation of her case. See sec. 7430(c)(1)(B)(ii). Based principally on the entries in Mr. Mulder's affidavit, however, we do believe that McEvoy & Co. did perform some necessary litigation services that give rise to fees that are compensable. We make our best estimate and allow a claim for 8.5 hours. See Golsen v. Commissioner, supra. We value Mr. McEvoy's work at the rate of $92 an hour. Therefore, we will award a judgment for litigation costs incurred in connection with the work of McEvoy & Co. in the amount of $782.

Unreasonable Protraction of Proceeding

Section 7430(b)(4) provides: "No award for reasonable litigation * * * costs may be made under subsection (a) with respect to any portion of the * * * court proceeding during which the prevailing party has unreasonably protracted such proceeding." In the objection, respondent argues that, by letter dated September 29, 1992, respondent's Examination Division notified petitioner and David Ragan that it had audited petitioner's income tax returns for the years in issue in this case and was proposing that no changes be made to those returns (the September 29 letter). Respondent concedes that her Appeals Office and counsel were not then aware of that letter. Respondent concedes that her Appeals Office and counsel were not then aware of that letter. Respondent argues, however, that the letter, in effect, ended respondent's dispute with petitioner and that petitioner could have mitigated her litigation costs by bringing the letter to the attention of respondent's counsel. Respondent argues that it is unreasonable for petitioner to make no effort to mitigate her litigation costs in a situation where those costs are avoidable. We agree. Petitioner has not, by affidavit or otherwise, challenged respondent's assertion as to the existence of the September 29 letter. Petitioner has not explained her failure to bring that letter to the attention of respondent's counsel. We agree with respondent that

petitioner failed to mitigate her litigation costs and unreasonably protracted this proceeding with respect to the issues referenced in the September 29 letter. We do not, however, believe that the claims for litigation costs that we will allow (re: Mr. Mulder and Mr. McEvoy) involve costs incurred by petitioner during the period in which she unreasonably protracted the proceedings in the instant case.

Disposition of Claim

Rule 232(a)(3) provides that a motion for reasonable litigation cost ordinarily will be disposed of without a hearing unless it is clear from the motion and response thereto that there is a bona fide factual dispute that cannot be resolved without an evidentiary hearing. We do not believe that there is such a bona fide factual dispute here. Petitioner has produced substantial information by affidavit. We have been explicit in our demands for information and we assume that petitioner has complied with those demands to the extent of her ability to do so. As indicated above, we accept the facts set forth by petitioner in the affidavits attached to the motion and in the additional affidavits. Accepting those facts, we find that petitioner has failed to prove that she is entitled to an award of attorney's fees and litigation costs under section 7430 beyond the award that we order today. We do not believe that a hearing is necessary for us to resolve the dispute between the parties.

Disposition

On the premises stated above, it is

ORDERED AND DECIDED that petitioner's amended motion for attorney fees and costs under section 7430 is granted to the extent that the amount of reasonable litigation costs to be paid by respondent to petitioner is $1,762. It is further

ORDERED AND DECIDED that there are no deficiencies in income tax due from, nor overpayments due to, petitioner for the taxable years 1980, 1981, and 1982.

That for the taxable year 1981, $127,401 is a substantial underpayment attributable to tax-motivated transactions, for purposes of computing the interest payable with respect to such amount, pursuant to section 6621(c).

That there is no addition to tax due under section 6621(c) from petitioner for the taxable years 1980 and 1982.

That there is no addition to tax due under section 6653(a) from petitioner for the taxable years 1980.

That there is no addition to tax due under section 6651(a) from petitioner for the taxable years 1980 and 1981.

That there are no additions to tax due under sections 6653(a)(1) and 6653(a)(2) from petitioner for the taxable years 1981 and 1982.

That there is no addition to tax due under section 6661 from petitioner for the taxable years 1982.

/Signed/

James S. Halpern
Judge

Entered: Jan. 23, 1997

135 F.3d 329 (5th Cir. 1998)

JACQUELINE RAGAN,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee

No. 97-60105
United States Court of Appeals,
Fifth Circuit.
Feb. 17, 1998.

Docket: 97-60105 Filed February 17, 1998

Bruce M. Rose, Westchester, IL, Thomas E. Redding, Redding & Associates, Houston, TX, for Petitioner-Appellant.

Joan I. Oppenheimer, Gary William Allen, U.S. Dept. of Justice, Tax Div., Appellate Section, Washington, DC, Gilbert S. Rothenberg, U.S. Department of Justice, Tax Division, Washington, D.C., Charles Casazza, Clerk, U.S. Tax Court, Washington, DC, Stuart L. Brown, Chief Counsel, Internal Revenue Service, Washington, DC, for Respondent-Appellee.

Appeal from the Decision of the United States Tax Court.

Before POLITZ, Chief Judge, and HIGGINBOTHAM and DEMOSS, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Jackie Ragan appeals the Tax Court's denial of her petition seeking an income tax refund. Jackie also challenges the Tax Court's rulings on her motions for attorneys' and accountants' fees and for sanctions against the IRS. We AFFIRM the Tax Court's judgment with respect to the refund and sanctions issues, REVERSE the Tax Court's judgment awarding attorneys' and accountants' fees and REMAND for a new calculation of fees.

I

Jackie and David Ragan reside in Texas and filed joint income tax returns for 1980-84. The income reported for 1980 derived from

David's wages from his employment at ContiArbitrage-Houston. In April 1985, the Ragans requested an income tax refund for 1980 due to a large net operating loss carryover from their 1984 return. The IRS asked the Ragans to extend the statutes of limitations for the relevant returns in order to conduct an audit to determine if they were entitled to a refund. The Ragans agreed to do so and the audit commenced in April 1985.

In August 1985, David filed a voluntary petition in bankruptcy. As part of that proceeding, he asserted a claim of $108,935 against the United States which was the amount of the refund he and Jackie sought for 1980. The IRS filed a claim against David's bankruptcy estate for $11 million based on preliminary findings it had made in its audit. In addition, the IRS argued that any refund to which David was entitled was subject to setoff for the employment taxes he owed. Ultimately, the bankruptcy trustee and the IRS entered into a court-approved settlement under which the IRS paid the trustee the 1980 refund, offset by unpaid pre-petition employment taxes, penalties, and interest, and dropped its $11 million claim against David's estate.

In June 1987, David turned over to the IRS's Criminal Investigation Division all of his financial records. In February 1989, David was indicted for mail and wire fraud relating to financial transactions he made in the course of his employment. David was convicted, but this court reversed his conviction on appeal for insufficient evidence. *United States v. Ragan*, 24 F.3d 657 (5th Cir. 1994). David was also a party in a multi-district civil suit alleging that he participated in fraudulent transactions while employed for ContiArbitrage-Houston. *See In re ContiCommodities Servs., Inc.*, 733 F. Supp. 1555 (N.D. Ill. 1990), *affd in part sub nom, ContiCommodity Servs., Inc., v. Ragan*, 63 F.3d 438 (5th Cir. 1995), *cert. denied*, 116 S. Ct. 1318 (1996).

In late 1989, Jackie terminated her extension of the statutes of limitations on the joint tax returns. As a result, on April 27, 1990, the IRS sent Jackie a statutory notice of deficiency for at least $1.7 million in income taxes and penalties for 1980-82. The notice of deficiency also demanded that Jackie repay $50,695.31 for the "erroneous" 1980 refund the IRS paid to David's bankruptcy estate and disallowed the Ragans' farm-related expenses, losses of the R&H Associates, government securities and futures trading deductions, and losses relating to investments in two national limited partnerships.

On July 30, 1990, Jackie filed a petition in the United States Tax Court contesting the notice of deficiency and asserting that she was entitled to one-half of the 1980 refund previously paid to David's bankruptcy estate. The IRS filed an answer to Jackie's petition in which it denied that any of its allegations in the notice were erroneous.

On September 29, 1992, the IRS Examination Division sent David and Jackie a letter that there was "no-change" in their tax liabilities for the years 1980-84. In June or July 1993, the IRS Appeals Division learned of the "no change" letter and sent Jackie a proposed settlement showing that she was not liable for any deficiencies. Jackie and the IRS eventually settled all matters in the notice of deficiency. Jackie did not inform the IRS attorney working on her case about receiving the "no-change" letter until February 20, 1996.

After the settlement on the deficiencies, Jackie continued to pursue her claim for one-half of the 1980 refund. In addition, Jackie moved for sanctions against the IRS under Tax Ct. R. 33. The IRS filed a response opposing the sanctions motion. The Tax Court denied Jackie's motion for sanctions and further held that Jackie was not entitled to any portion of the 1980 refund paid to David's bankruptcy estate.

After the resolution of the substantive claim, Jackie filed a renewed motion for sanctions and a petition for attorneys' and accountants' fees. The Tax Court denied her request for sanctions. As for her petition for fees, the Tax Court ordered detailed affidavits describing the billing practices of her attorneys and accountants. After Jackie submitted this information, the Tax Court awarded her $1,762 in attorneys' and accountants' fees.

Jackie timely filed a notice of appeal of the Tax Court's orders resolving her claim to the 1980 refund, her motions for sanctions, and her petition for fees and costs. We have jurisdiction under 26 U.S.C. § 7482(a)(1). Venue is proper in the Fifth Circuit under 26 U.S.C. § 7482(b)(1)(A) because Jackie is, and was for the years in issue, a legal resident of Houston, Texas.

II

The parties agree that whether Jackie is entitled to one-half of the 1980 refund depends on the legal classification of the refund under Texas's community property regime. The proper standard of review

is *de novo*. *Vinson & Elkins v. C.I.R.*, 7 F.3d 1235, 1237 (5th Cir. 1993).

Under 11 U.S.C. § 541(a), David's bankruptcy estate included "[a]ll interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is under the sole, equal, or joint management and control of the debtor." *Id.* §541(a)(2). Consequently, Jackie can prevail on her claim only if she establishes that one-half of the 1980 refund was community property under her sole management and control.

Jackie argues that the characterization of the refund rests on who has control over the refund at the time the determination must be made, here the filing of David's bankruptcy petition. When a husband and wife file a joint return, each has a separate interest in the jointly reported income and in any overpayment. Rev. Rul. 74-611. "In a community property state, each spouse is considered the recipient of one-half of the wages upon which taxes are withheld and thus is entitled to a credit for one-half of the taxes that are withheld." Rev. Rul. 80-7. From these principles, Jackie draws the conclusion that one-half of the refund is subject to her sole management and control.

Persuasive authorities have rejected this argument. They reason from the precept that "the source of an overpayment of income tax determines the character of the refund, with a refund of excess withholding tax merely being a repayment of earnings from employment." *In re Bathrick*, 1 B.R. 428, 430 (Bkrtcy.S.D. Tex. 1979); *see also Gehrig v. Shreves*, 491 F.2d 668, 671-72 (8th Cir. 1974). Since personal earnings, while community property, are subject to the sole management and control of the spouse who earned them, Tex. Family Code Ann. § 3.102(a) (West Supp. 1998), the tax refund generated from the excess withholding of those earnings is as well. *In re Bathrick*, 1 B.R. at 430; *accord In re Burke*, 150 B.R. 660, 661 (Bkrtcy.E.D. Tex. 1993); *In re Barnes*, 14 B.R. 788, 790 (Bkrtcy.N.D. Tex. 1981); *In re Hilliou*, 1976 WL 1031 (E.D. Va. May 3, 1976).

Jackie did not dispute that the 1980 refund derived solely from the excess withholding of David's personal earnings. The court, following *Bathrick*, held that she was not entitled to any portion of it.

We agree with the Tax Court. "[T]he case law overwhelmingly establishes that overpayments by married couples are apportionable

to each spouse to the extent that he or she contributed to the overpaid amount." *Hathaway v. United States*, 93-1 U.S.T.C. P 50,285 (E.D. Wash. 1993) (citing cases). Filing jointly does not give one spouse an interest in the income of the other. Rev. Rul. 74-611. "[A] premarital or postmarital loss or credit may be applied only against the income of the person who incurred the loss or credit." *Id.* A joint income tax return does not create new property interests for the husband or wife in each other's income tax overpayment. *Id.* Under Jackie's theory, filing a joint tax return would change the character of David's personal earnings from David's sole management community property to Jackie's sole management community property with respect to one-half of the earnings that were withheld in excess. The tax laws do not countenance such a metamorphosis. Thus, we hold that, to the extent that the income is attributable to one spouse's sole management community property, the refund from the excess tax on that income is the sole management community property of that spouse. Jackie is not entitled to any portion of the 1980 refund.

III

We review the Tax Court's award of attorneys' fees for abuse of discretion and its subsidiary findings of fact for clear error. *Powers v. C.I.R.*, 43 F.3d 172, 179 (5th Cir. 1995).

A prevailing party in a Tax Court proceeding may be awarded attorneys' fees if she (1) substantially prevailed with respect to the amount in controversy or as to the most significant issue or set of issues presented, (2) met the net worth requirements, (3) exhausted all administrative remedies, and (4) established that the position of the United States on the issue presented was not substantially justified. 26 U.S.C. § 7430 (1989). Though she may satisfy these requirements, the prevailing party is not entitled to attorneys' fees for any portion of the proceeding which she has unreasonably protracted. *Id.* The prevailing party must also show that her fees and litigation costs are reasonable. *Id.*

There are only three remaining disputes between the parties on the attorneys' fees and litigation costs issue: (A) whether the IRS was substantially justified in demanding that Jackie repay the 1980 refund it paid to David's bankruptcy estate; (B) whether Jackie unreasonably protracted the Tax Court proceeding by not disclosing the September 29, 1992 "no-change" letter to the IRS attorney litigating this case until February 20, 1996; and (C) whether Jackie's attorneys' fees and

costs were reasonable.

A

In the notice of deficiency, the IRS demanded that Jackie repay the 1980 refund it "erroneously" paid to David's bankruptcy estate. The IRS made this demand to protect itself in case it lost on Jackie's claim for one-half of the 1980 refund. The Tax Court accepted the IRS's explanation for the demand and concluded there was no "erroneous" refund issue to decide. Jackie claims that she is entitled to attorneys' fees and costs expended in defending the demand because it was not substantially justified.

Jackie has the burden to show that the IRS's position was not substantially justified. 26 U.S.C. § 7430(c)(4) (1989); *see also Heasley v. C.I.R.*, 967 F.2d 116, 120 (5th Cir. 1992). "A position is substantially justified when it is 'justified to a degree that could satisfy a reasonable person.'" *Heasley*, 967 F.2d at 120 (quoting *Pierce v. Underwood*, 487 U.S. 552, 565, 108 S.Ct. 2541, 2550, 101 L.Ed.2d 490 (1988)). The time for its determination is the earlier of (1) the date petitioner receives notice of the decision of the IRS Office of Appeals, or (2) the date of the notice of deficiency. 26 U.S.C. § 7430(c)(7) (1989). The applicable time in this case is the date of the notice of deficiency, April 27, 1990.

It was disingenuous for the IRS to demand that Jackie repay the 1980 refund. Jackie never had any interest in the refund. The IRS knew that it had paid the refund to the bankruptcy trustee. Seeking the refund from Jackie was futile, which was later shown by the IRS's admission that it never expected to recover the refund from her. The IRS was not substantially justified in demanding repayment of the 1980 refund from Jackie. The IRS abuses its power by such tactics. Citizens are entitled to more from their government, and the tax collector has no pass. Jackie is entitled to recover attorneys' fees and costs for defending against the IRS's demand for repayment of the 1980 refund. We reverse the Tax Court's contrary holding.

B

The Tax Court found that Jackie had unreasonably protracted the litigation by not disclosing the "no-change" letter to the IRS attorney working on her case until February 20, 1996. As a result, it denied Jackie any attorneys' fees or costs incurred after September 29, 1992, the date of the "no-change" letter.

The IRS relies on *Polyco, Inc., v. C.I.R.*, 91 T.C. 963, 1988 WL 127834 (1988), to support the Tax Court's ruling on this issue. This reliance is misplaced, however, because the actions of the taxpayer in that case were different from Jackie's conduct here. In *Polyco*, the taxpayer was found to have protracted unreasonably the civil proceedings because his attorney consistently refused to meet with the IRS and violated the court's Standing Pretrial Order for disclosing trial records. *Id.* at 967. That has not been Jackie's conduct. She readily turned over all documents the IRS requested and met with IRS agents on numerous occasions. More importantly, the IRS Appeals Division conducted Jackie's audit and sent the "no-change" letter to Jackie and David. The IRS admits that the District Counsel and Appeals Division learned of the letter in June or July 1993. The IRS claims that it thought the letter went only to David, an excuse of no moment since David and Jackie filed jointly.

The IRS is responsible for the documents it distributes to taxpayers. *See Han v. C.I.R.*, 1993 WL 325058 (U.S. Tax Ct. Aug. 24, 1993) (imposing sanctions on IRS for failing to honor discovery request for documents in taxpayer's administrative file). The Tax Court erred in placing a legal duty on Jackie to disclose to the IRS attorney handling her case the "no-change" letter the IRS had drafted, mailed, and possessed. *See Johnson v. C.I.R.*, No. 92-04270 (5th Cir. March 23, 1993) (unpublished). We conclude that Jackie did not unreasonably protract the proceedings before the Tax Court and is not precluded from recovering attorneys' fees and costs incurred after January 29, 1992.

C

The Tax Court found unreasonable Jackie's submission for attorneys' fees and costs. The court first examined Jackie's overall request for fees and then the fees claimed for each individual attorney or accountant.

1

The Tax Court held that Jackie's total claim for attorneys' fees of $154,105.85 was unreasonable because a supplemental affidavit of Bruce Rose, one of Jackie's attorneys, reported $20,000 less in fees than his original affidavit. Jackie argues that the Tax Court abused its discretion because the discrepancy in Rose's affidavits was due to his including in his original, but not supplemental, affidavit his fees for

preparing the § 7430 petition and sanctions motion.

In a proceeding to determine an award of attorneys' fees, an attorney may include in his supporting affidavit his fees for preparing the petition seeking litigation costs. *Cassuto v. C.I.R.*, 93 T.C. 256, 270, 1989 WL 98722 (1989), *affd in part, rev'd in part*, 936 F.2d 736 (2d. Cir. 1991). Following this principle, we see no reason why an attorney may not include in his supporting affidavit his fees for preparing a motion for sanctions submitted simultaneously with the petition for attorneys' fees. The Tax Court summarily disposed of Jackie's total request for attorneys' fees without delving into the basis for the discrepancy between Rose's supporting affidavits. That was error.

2

An attorney must do more than submit a broad summary of work done and hours logged to justify an award of attorneys' fees. *Bode v. United States*, 919 F.2d 1044, 1047 (5th Cir. 1990). A lawyer must present adequate evidence of the hours spent on the case and that those hours were reasonably expended. *Heasley v. C.I.R.*, 967 F.2d 116, 123 (5th Cir. 1992). The Tax Court ordered each of Jackie's attorneys and accountants to submit a detailed summary, in the form of a chart showing such items as date, issue, time expended and nature of the services performed, justifying his claim for fees. Failure of an attorney to fulfill all the reporting requirements in a Tax Court's order does not preclude an award of fees for that attorney. *See Heasley*, 967 F.2d at 123-24.

a

The Tax Court refused to award Jackie any fees with respect to attorney Thomas Redding because his billing summary did not delineate the issues on which he had worked. Our review of the record shows that Redding worked on Jackie's claim to the 1980 refund and on her § 7430 petition for attorneys' fees. Jackie is entitled to recover fees with respect to the latter issue but not the former. Though not elaborate, we do not think Redding's billing sheets were so cryptic as to preclude an award of fees. Given the abbreviated nature of his billing summary, however, we refuse to award Redding for any time he spent on Jackie's case prior to April 20, 1995, the day the Tax Court denied Jackie's refund request. Because he worked on her petition for attorneys' fees, the Tax Court abused its discretion in

disavowing Jackie any recovery with respect to Redding's efforts on her behalf.

b

The Tax Court denied Jackie an award of attorneys' fees for Bruce Rose because it found that Rose did not work on issues for which Jackie was entitled to an § 7430 award. The Tax Court based its ruling on Rose's affidavit indicating that the majority of his time spent on Jackie's case pre-dated his admission and appearance before the Tax Court and was not directed by one of Jackie's attorneys who was admitted to practice before the Tax Court. The Tax Court clearly erred in finding that Rose did not expend any efforts on a recoverable issue in Jackie's case. Though he primarily represented David in the related civil cases, Rose also dedicated time to issues in Jackie's case for which she is entitled an award of attorneys' fees, such as disputing the IRS's demand that Jackie repay the 1980 refund and preparing the § 7430 petition. Though an attorney's report to the Tax Court must be sufficiently detailed, we have found that a summary stating the hours billed and by whom met the reporting requirements where it was obvious the attorney had participated extensively in the case. *Powers*, 43 F.3d at 181. Thus, we conclude that the Tax Court abused its discretion in not awarding Jackie attorneys' fees for any of the time Rose worked on her case.

c

The Tax Court awarded Jackie fees for only 10 of the 33.75 hours attorney James Mulder submitted for his time of service because it was unable to determine the issues upon which Mulder worked. Since Mulder prepared Jackie's original petition, the Tax Court believed that Mulder did perform some work on issues for which Jackie could recover attorneys' fees. Ten hours was the court's best estimate of his compensable time.

When an affidavit lacks detail necessary to determine precisely an attorney's fees, the court may estimate the time the attorney spent on compensable issues. *See Powers*, 43 F.3d at 181. The record shows that Mulder spent his time preparing and prosecuting Jackie's original petition in the Tax Court. Jackie is entitled to recover attorneys' fees on all issues presented in the original petition, except for her claim to the 1980 refund and the losses associated with the national partnerships. Estimating Mulder's compensable time to be only ten

hours given the numerous issues in the petition on which Jackie is entitled to an award of fees was an abuse of discretion.

d

The Tax Court denied almost all of the fees Jackie submitted for the accounting services McEvoy & Co. performed for her case. The court ruled that McEvoy failed to distinguish between its efforts for Jackie's case and those for David's civil suits. In addition, the court held that in order to recover fees under § 7430, an accountant must show that the work undertaken was done pursuant to the direction or employ of an individual authorized to practice before the Tax Court. The Tax Court found that McEvoy could not make such a showing for most of the hours it worked on Jackie's case. The Tax Court estimated that McEvoy deserved compensation for 8.5 hours of the 829 hours it submitted.

Jackie may not recover the total amount of fees for McEvoy's services since its work was for David's civil suits as well as Jackie's case. *See Mearkle v. C.I.R.*, 90 T.C. 1256, 1261-62, 1988 WL 64612 (1988). It does not follow that virtually all of McEvoy's fees properly can be disregarded. Since McEvoy was Jackie's and David's accountant, they both reasonably required McEvoy's work in preparing for their separate but related trials.

The Tax Court also held that "reasonable litigation costs . . . do not include the fees of an accounting firm not working under the direction or employ of an individual authorized to practice before the Court." *Guyan Oil Co. v. Commissioner*, No. 5463-86, 1988 WL 102180 (U.S. Tax Ct. Oct. 6, 1988), upon which the Tax Court based its holding, does not stand for this principle. In *Guyan Oil*, the court, in *dicta*, indicated that if an accountant was seeking reimbursement under § 7430 for handling the legal aspects of his client's case, he must be admitted to the Tax Court or working under the direction of someone who was. *Id.* at *6; *see also* 26 U.S.C. § 7430(c)(3). In such a situation, the accountant is receiving "attorneys' fees" and not fees as an expert witness. *See Cozean v. C.I.R.*, No. 19318-95, 1997 WL 633247 (U.S. Tax Ct. Oct. 15, 1997). The Tax Court cites no other authority for its proposition. We reverse the Tax Court's ruling and hold that the fees of one who prepares an analysis or report necessary for a party's case are recoverable as reasonable litigation costs, irrespective of whether the person is admitted to practice before the Tax Court, or employed by someone who is. *See* 26 U.S.C. §

7430(c)(1)(B)(i) (Supp. 1997).

In this case, McEvoy prepared analyses which were significant to Jackie's case in defending against the notice of deficiency. Moreover, Mulder, and later Rose, enlisted McEvoy as an expert for Jackie's case. McEvoy's work relates to issues upon which Jackie is entitled to recover litigation costs. The Tax Court erred in awarding Jackie only a modicum of McEvoy's fees based on the court's incorrect reading of *Guyan Oil*.

We reverse the award of attorneys' and accountants' fees and remand for a new calculation consistent with this opinion.

IV

Jackie's motions for sanctions against the IRS, first under Tax Ct. R. 33 and then under Rule 33 and 26 U.S.C. § 6673 (Supp. 1997), were denied. We review for abuse of discretion. *See First Nat'l Bank v. Lustig*, 96 F.3d 1554, 1573 (5th Cir. 1996).

Rule 33 parallels Fed R. Civ. P. 11, including an award of attorneys' fees for its violation. *Versteeg v. C.I.R.*, 91 T.C. 339, 1988 WL 86346 (1988). Section 6673(a)(2) imposes liability on the United States for excess costs, expenses, and attorneys' fees if an attorney for the United States unreasonably and vexatiously multiplies the proceedings before the Tax Court. 26 U.S.C. § 6673(a)(2) (Supp. 1997).

Jackie asserts that the IRS's answer to her petition was not well grounded in fact and supported by existing law at the time it was filed. At that time, the IRS's audit of the Ragans had been ongoing for five years. When filing its answer, Jackie claims that the IRS either knew that she and David did not owe any tax deficiency other than that relating to the national partnerships, or that it had failed to perform any investigation of Jackie's tax liability. For support, Jackie points to the IRS's capitulation with respect to the asserted tax liabilities, other than the national partnerships, three years after the answer was filed. We disagree. The IRS filed its answer on September 27, 1990. At that time, there were both civil and criminal investigations into the legitimacy of David's financial transactions during his employ at ContiArbitrage-Houston. The IRS's notice of deficiency against Jackie was based in part on these same transactions. The IRS was not unreasonable in alleging that Jackie owed additional taxes and penalties resulting from David's trading

activities.

Jackie also contends that the errors in the IRS's response to her first motion for sanctions give rise to a Rule 33 violation. The Tax Court acknowledged that the affidavit of Teresa Barnett, attached to the IRS's response, incorrectly stated that the partnerships in which the Ragans had an interest engaged in government securities trading. The court believed, however, that Jackie was exaggerating the significance of these inaccurate statements. We agree with the Tax Court. Though the IRS's response was not perfect, it does not warrant sanctions under Rule 33.

Finally, with respect to Jackie's claim for sanctions under § 6673(a)(2), the Tax Court did not abuse its discretion in ruling that no IRS attorney had multiplied the proceedings unreasonably or vexatiously. Jackie's case was part of a complex situation involving several civil suits and a criminal prosecution. Though the IRS could have been more diligent in processing Jackie's petition, its conduct was not so egregious as to justify the extraordinary action of imposing sanctions under § 6673.

V

To sum, we AFFIRM the Tax Court's judgment denying Jackie's claim to one-half of the 1980 refund and her motions for sanctions, REVERSE the Tax Court's judgment awarding Jackie attorneys' and accountants' fees, and REMAND for a new calculation of attorneys' and accountants' fees.

11 U.S.C. §541(a)

UNITED STATES CODE
TITLE 11. BANKRUPTCY
CHAPTER 5--CREDITORS, THE DEBTOR, AND THE ESTATE
SUBCHAPTER III--THE ESTATE

§ 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

(2) All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is--

(A) under the sole, equal, or joint management and control of the debtor; or

(B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

(3) Any interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title.

(4) Any interest in property preserved for the benefit of or ordered transferred to the estate under section 510(c) or 551 of this title.

(5) Any interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date--

(A) by bequest, devise, or inheritance;

(B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce

decree; or

(C) as a beneficiary of a life insurance policy or of a death benefit plan.

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

(7) Any interest in property that the estate acquires after the commencement of the case.

26 U.S.C. §6402
UNITED STATES CODE
TITLE 26. INTERNAL REVENUE CODE
SUBTITLE F--PROCEDURE AND ADMINISTRATION
CHAPTER 65--ABATEMENTS, CREDITS, AND REFUNDS
SUBCHAPTER A--PROCEDURE IN GENERAL

§ 6402. Authority to make credits or refunds

(a) General rule.--In the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to subsections (c) and (d), refund any balance to such person.

26 U.S.C.A. §6673
UNITED STATES CODE ANNOTATED
TITLE 26. INTERNAL REVENUE CODE
SUBTITLE F--PROCEDURE AND ADMINISTRATION
CHAPTER 68--ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES
SUBCHAPTER B--ASSESSABLE PENALTIES
PART I--GENERAL PROVISIONS.

§ 6673. Sanctions and costs awarded by courts

(a) Tax Court proceedings.--

(1) Procedures instituted primarily for delay, etc.--Whenever it appears to the Tax Court that--

(A) proceedings before it have been instituted or maintained by the taxpayer primarily for delay,

(B) the taxpayer's position in such proceeding is frivolous or groundless, or

(C) the taxpayer unreasonably failed to pursue available administrative remedies,

the Tax Court, in its decision, may require the taxpayer to pay to the United States a penalty not in excess of $25,000.

(2) Counsel's liability for excessive costs.--Whenever it appears to the Tax Court that any attorney or other person admitted to practice before the Tax Court has multiplied the proceedings in any case unreasonably and vexatiously, the Tax Court may require--

(A) that such attorney or other person pay personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct, or

(B) if such attorney is appearing on behalf of the Commissioner of Internal Revenue, that the United States pay such excess costs, expenses, and attorneys' fees in the same manner as such an award by a district court.

(b) Proceedings in other courts.--

(1) Claims under section 7433.--Whenever it appears to the

court that the taxpayer's position in the proceedings before the court instituted or maintained by such taxpayer under section 7433 is frivolous or groundless the court may require the taxpayer to pay to the United States a penalty not in excess of $10,000.

(2) Collection of sanctions and costs.--In any civil proceeding before any court (other than the Tax Court) which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, any monetary sanctions, penalties, or costs awarded by the court to the United States may be assessed by the Secretary and, upon notice and demand, may be collected in the same manner as a tax.

(3) Sanctions and costs awarded by a court of appeals.--In connection with any appeal from a proceeding in the Tax Court or a civil proceeding described in paragraph (2), an order of a United States Court of Appeals or the Supreme Court awarding monetary sanctions, penalties or court costs to the United States may be registered in a district court upon filing a certified copy of such order and shall be enforceable as other district court judgments. Any such sanctions, penalties, or costs may be assessed by the Secretary and, upon notice and demand, may be collected in the same manner as a tax.

Texas Family Code §3.102(a)

TEXAS FAMILY CODE
TITLE 1. THE MARRIAGE RELATIONSHIP
SUBTITLE B. PROPERTY RIGHTS AND LIABILITIES
CHAPTER 3. MARITAL PROPERTY RIGHTS AND LIABILITIES
SUBCHAPTER A. GENERAL RULES FOR SEPARATE AND COMMUNITY PROPERTY

§ 3.102. Managing Community Property

(a) During marriage, each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single, including:

(1) personal earnings;

(2) revenue from separate property;

(3) recoveries from personal injuries; and

(4) the increase and mutations of, and the revenue from, all property subject to the spouse's sole management, control and disposition.

Rule 11 of the Federal Rules of Civil Procedure

UNITED STATES CODE ANNOTATED
FEDERAL RULES OF CIVIL PROCEDURE
FOR THE UNITED STATES DISTRICT COURTS
III. PLEADINGS AND MOTIONS

Rule 11. Signing of Pleadings, Motions, and Other Papers; Representations to Court; Sanctions

(a) Signature. Every pleading, written motion, and other paper shall be signed by at least one attorney of record in the attorney's individual name, or, if the party is not represented by an attorney, shall be signed by the party. Each paper shall state the signer's address and telephone number, if any. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) Representations to Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) How Initiated.

(A) By Motion. A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 5, but shall not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected. If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

(B) On Court's Initiative. On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.

(2) Nature of Sanction; Limitations. A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation.

(A) Monetary sanctions may not be awarded against a represented party for a violation of subdivision (b)(2).

(B) Monetary sanctions may not be awarded on the court's initiative unless the court issues its order to show cause before a voluntary dismissal or settlement of the claims made by or against the party which is, or whose attorneys are, to be sanctioned.

(3) Order. When imposing sanctions, the court shall describe the conduct determined to constitute a violation of this rule and explain the basis for the sanction imposed.

(d) Inapplicability to Discovery. Subdivisions (a) through (c) of this rule do not apply to disclosures and discovery requests, responses, objections, and motions that are subject to the provisions of Rules 26 through 37.

Tax Court Rule 33

Rules of Practice & Procedure United States Tax Court

Rule 33. Signing of Pleadings

(a) **Signature:** Each pleading shall be signed in the manner provided in Rule 23. Where there is more than one attorney of record, the signature of only one is required. Except when otherwise specifically directed by the Court, pleadings need not be verified or accompanied by affidavit.

(b) **Effect of Signature:** The signature of counsel or a party constitutes a certificate by the signer that the signer has read the pleading, that, to the best of the signer's knowledge, information, and belief formed after reasonable inquiry, it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. The signature of counsel also constitutes a representation by counsel that counsel is authorized to represent the party or parties on whose behalf the pleading is filed. If a pleading is not signed, it shall be stricken, unless it is signed promptly after the omission is called to the attention of the pleader. If a pleading is signed in violation of this Rule, the Court, upon motion or upon its own initiative, may impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, including reasonable counsel's fees.

CERTIFICATE OF SERVICE

This is to certify that

(i) three copies of the foregoing Petition for Writ of Certiorari were mailed by certified mail, return receipt requested, on July 23, 1998 to:

Solicitor General of the United States,
Department of Justice, Room 5614
10th Street and Constitution Ave., N. W.
Washington, D. C. 20530

(ii) one copy of the foregoing Petition for Writ of Certiorari was mailed by certified mail, return receipt requested, on July 23, 1998 to Counsel for the Internal Revenue Service:

Mr. Gary R. Allen
Department of Justice, Tax Division
P. O. Box 502
Washington D. C. 20044

and,

(iii) three copies of the foregoing Petition for Writ of certiorari were mailed by certified mail, return receipt requested, on July 23, 1998, to:

Commissioner of Internal Revenue
Washington, D. C. 20224

Date: 7/23/98

Thomas E. Redding